Political embeddedness and corporate strategies in China

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Political embeddedness and corporate strategies in China

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To my beloved family

致我的家人

"...I believe in working hard for what you've got, even if it don't add up to a hell of lot...
...I believe this world ain't half as bad as it looks, I believe most people are good..."

-Luke Bryan

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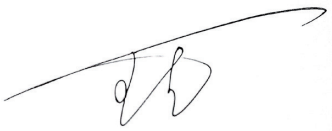
Zhi Wang (王志), Nijmegen, April 2018.



Contents

EM
GOVERNMENT
POLITICIANS

Chapter 1

Introduction

1.1 The influence of political embeddedness on corporate business

Political embeddedness of government in the economy exists worldwide. In his seminal research, Keynes (1936) contends that because the allocation of goods and services is not always efficient in a pure market economy, appropriate government intervention is essential. Since then, the relation between the government and the market has been one of the core issues of economics. In particular, the role of the government in emerging economies, which are often evolving from a centrally planned economy to a market-oriented economy, is widely debated in the economic literature (e.g., Boubakri and Cosset, 1998; Lee et al., 2014; Ma, 1995; Qian, 1994; Wang and Chang, 1998). Since the 1990s, scholars have directed increasing attention to the influence of government involvement in micro-economies (e.g., Boubakri and Cosset, 1998; Che and Qian, 1998; Lin et al., 1998; Xu and Wang, 1999) and examined both the "supporting hand" and the "grabbing hand" approaches (Frye and Shleifer, 1997; Shleifer, 1998; Shleifer and Vishny, 1994). The supporting hand approach argues that the government provides its affiliated firms with more useful resources. This also applies to China, the focal country in this dissertation. There is ample support for the resource advantages of politically embedded firms in China. Due to the natural bond with the government, politically embedded firms are, for example, found to gain more financial support from the government through easier access to debt financing (Brandt and Li, 2003; Megginson et al., 1994; Wei and Varela, 2003), lower taxation (Claessens et al., 2008; Faccio, 2010; Goldman et al., 2013; Johnson and Mitton, 2003; Khwaja and Mian, 2005), preferential access to government contracts (Goldman et al., 2009; Innes, 1991; Wang et al., 2008b), benefits from regulatory protection (Kroszner and Stratmann, 1998), and political bailouts (Wang et al., 2008b; Yu, 2013). The grabbing hand approach portrays government-owned firms as entities controlled by the government/politicians that pursue their own social and political objectives at the sacrifice of firm value (Boycko et al., 1996; Dewenter and Malatesta, 2001; Frye and Shleifer, 1997; Lin and Man-lai Wong, 2013; Shleifer and Vishny, 1994, 1998; Vining and Boardman, 1992). In this perspective, political embeddedness influences and directs corporate policies in favor of protecting the political interests and realizing the personal goals of politicians while leading to distortions in the distribution of resources and low economic efficiency. Given the two streams of the arguments, it remains unclear how political embeddedness influences corporate financial policies and strategies, especially in settings such as emerging economies.

The existing literature has identified two main channels through which corporate policies and strategies could be influenced by government involvement: shareholding (ownership) by the government (Dewenter and Malatesta, 2001; Shleifer, 1998; Xu and Wang, 1999) and the political network connections of firms'

management (Faccio, 2006; Fan et al., 2007; Wu et al., 2012b, 2012c).[1] First, a firm's shareholders, who function as the decisive authority of corporate affairs, could be the government. In this way, the government influences corporate affairs through government ownership. Second, even without ownership, the government could influence the management (i.e., the board of directors, the executives, and the supervisors) of a firm through political network connections. For example, a firm could be politically connected if one of its managers is or was a member of the political system. Government ownership and political connections are both important channels through which the government can influence corporate affairs and realize its social and political goals. Henceforth, in this dissertation, the term "political embeddedness" refers to the two channels of government influence (government ownership and political connections) together.

In addition, since different levels of the Chinese political system have different characteristics, and thus can have different effects on corporate affairs, it is also crucial to differentiate between the different levels of government ownership and political connections. In China, the relationship between the central and the local governments—including the provincial, municipal, county, and rural levels—is that of principal-agent (Xia and Fang, 2005). While the central government plays a role in governing the affairs of the entire country, the local governments are more like agents of the central government. Therefore, inter-regional competition among local governments is an important aspect of the economy (Lee et al., 2014). Due to their increasing decentralization, local governments have both the power and the incentive to intervene in corporate affairs to achieve their political objectives (Chen et al., 2011b; Lin et al., 1998), such as fiscal freedom (Jin et al., 2005) and political aspirations (Tu et al., 2013; Wang, 2015; Wu et al., 2012b). Chen et al. (2008), for example, found that the central government would require firms to provide high quality financial information; however, the local governments would assist the local firms to use earnings management with subsidies to whitewash the local firms' financial performance and thereby achieve a higher political performance. The incongruence of the goals between the central and the local governments may have different effects on the corporate affairs of their affiliated firms. Therefore, the only way to fully understand how political embeddedness affects corporate strategies is by addressing the political embeddedness at both the local and the central levels of government (Chen et al., 2011b; Marquis and Qian, 2014).

1 Other channels exist through which the government might draw influences on corporate strategies, such as policy-making on macro levels. However, this dissertation focuses on government's involvement in corporate affairs, which is mainly identified as government ownership and political connections by the existing literature.

1.2 Political embeddedness in the Chinese setting

Although political embeddedness is not unique to China, China is an extremely well-suited empirical setting for analyzing the effects of governmental involvement in the business strategies of politically embedded firms, as the Chinese market is characterized by both strong government intervention via state ownership and the pervasive existence of the political connections of firms (Gao, 2009; Lau et al., 2016; Marquis and Qian, 2014; Tian et al., 2011).

First, even after four decades of transformation from a centrally planned to a market-oriented economy, China's economy is still characterized by strong governmental control via government ownership (Lee et al., 2014; Xu and Zeng, 2016). The Chinese government remains the majority owner of the listed transformed firms (Wang et al., 2008b) and thus maintains de facto control of these firms (i.e., the ability to direct a company to act on the government's behalf) through practices of intervention in corporate affairs (Allen et al., 2005; Lee et al., 2014). Although the listed private firms[2] are growing in number and the private sector has fueled most of China's economic growth in the last two decades (Allen et al., 2005), the firms listed as "state owned enterprises" (SOEs) remain an extremely large proportion of the capital market in China (Wei et al., 2005; Xu and Wang, 1999). Therefore, the government exerts direct influence on corporate policies and strategic choices through the ownership of Chinese SOEs.

Figures 1.1 and 1.2[3], respectively, report the provincial distribution of the number and proportion of government-owned firms listed in mainland China in 2015. In absolute numbers, more government-owned firms are listed in the economically competitive provinces and municipalities, such as Beijing, Shanghai, Guangdong, Jiangsu, and Shandong. However, the proportion of government-owned firms in these regions is relatively low in comparison to the economically less-developed regions, such as Xinjiang, Gansu, Yunnan, and Guizhou. With more private firms in the developed than in the developing regions, this clearly shows a heterogeneous pattern of government embeddedness in the Chinese economy.

Second, as another dimension of political embeddedness, the political connections between corporate executives and the government or congress exist widely in both SOEs and non-SOEs (Faccio, 2006, 2010; Faccio et al., 2006; Fan et al., 2007; Li et al., 2008; Tu et al., 2013). There are numerous examples of companies in which corporate executives are also current or former local or central government officials or members of congress (Ma and Parish, 2006; Marquis and Qian, 2014). Such political connections are therefore extremely likely to function as indirect ties for

2 In this dissertation, the term "private firms" refers to firms that are not government-owned.

3 The data contained in Figures 1.1-1.4 are calculated based on the data from China Stock Market and Accounting Research (CSMAR) database.

the government to exert its political influence and pressure on corporate policies and strategic choices.

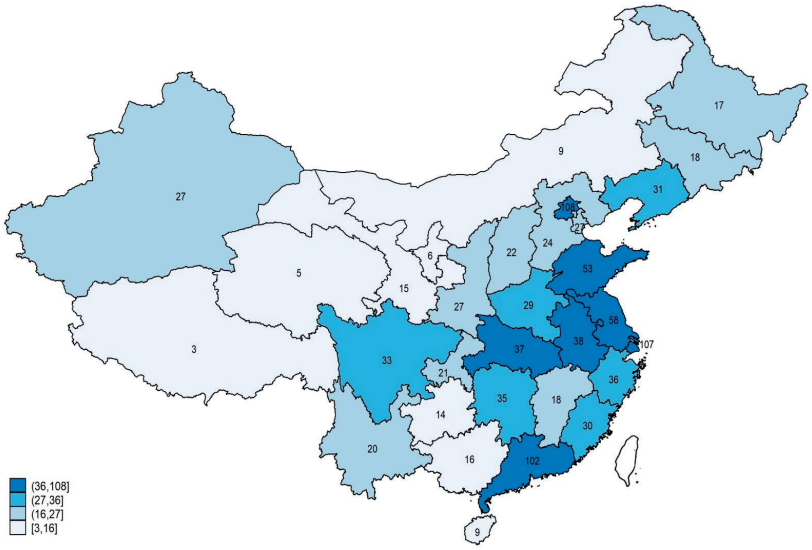


Figure 1.1: The provincial distribution of the number of government-owned firms listed in mainland China in 2015

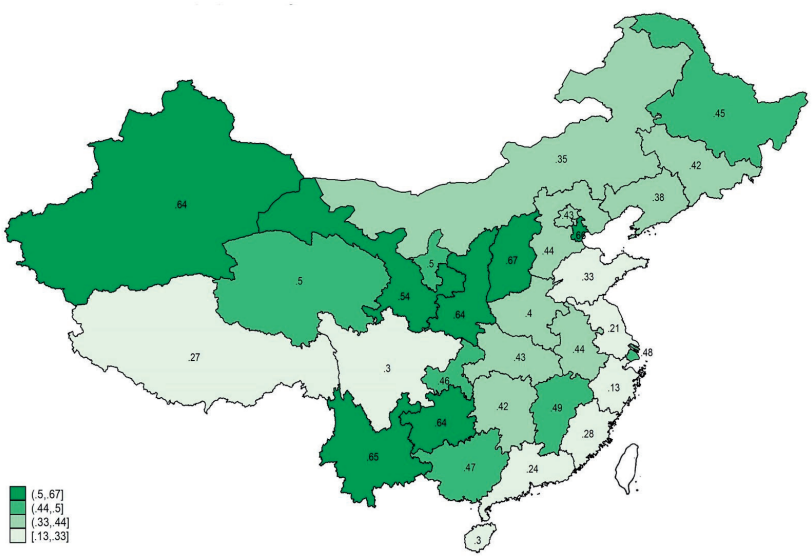


Figure 1.2: The provincial distribution of the proportion of government-owned firms listed in mainland China in 2015

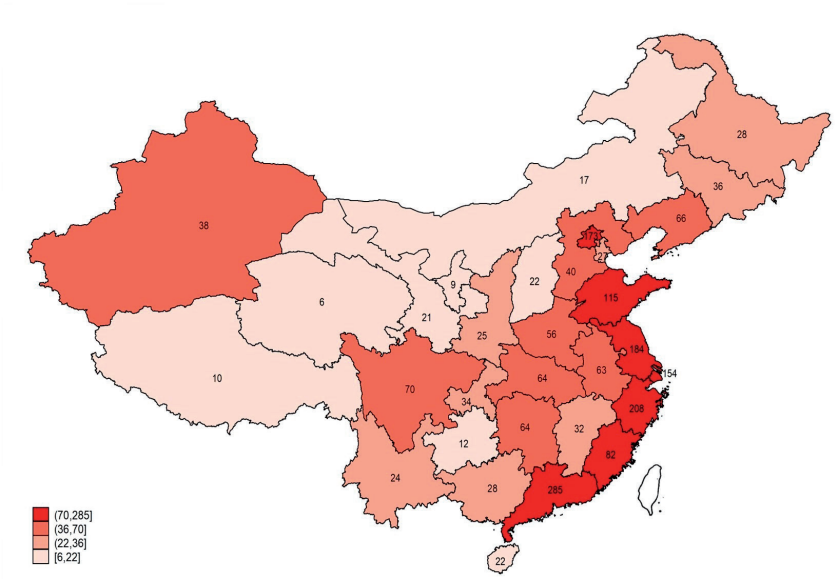


Figure 1.3: The provincial distribution of the number of politically-connected firms listed in mainland China in 2015

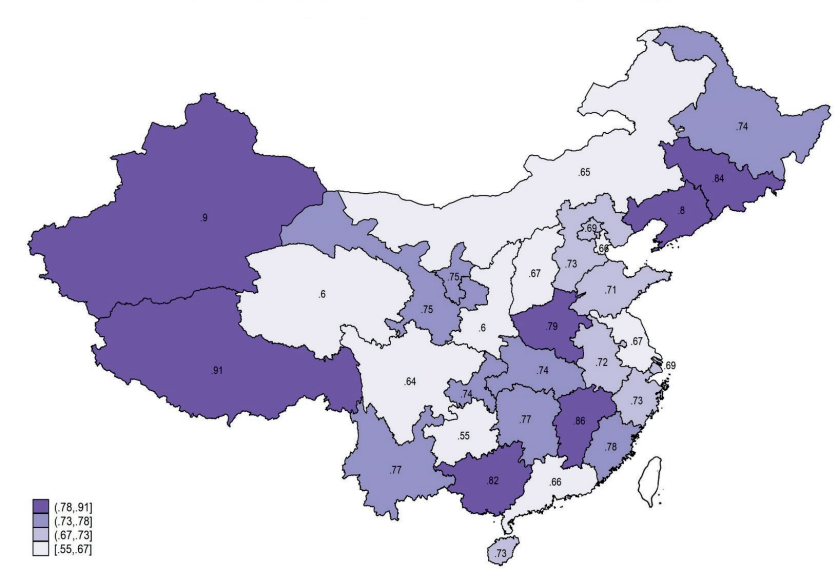


Figure 1.4: The provincial distribution of the proportion of politically-connected firms listed in mainland China in 2015

Figures 1.3 and 1.4, respectively, present the provincial distribution of the number and proportion of politically-connected firms listed in mainland China in 2015. Similar to the situation with government-owned firms, the provinces alongside

the eastern coastline (Beijing, Shandong, Jiangsu, Shanghai, Zhejiang, Fujian, and Guangdong) have the largest number of firms with political connections, while the less-developed regions (such as Xinjiang, Tibet, Jiangxi, Guangxi, Jilin, and Liaoning) have high proportions of politically connected firms.

1.3 Corporate finance-related policy changes in China

After several decades of rapid development, China is currently ranked as the world's second largest economy in terms of gross domestic product (World Bank, 2016). One of the most salient characteristics of the Chinese economy is its phenomenal increase in foreign direct investment (FDI), both inward and outward. On the one hand, China has been attracting an increasing number of investments from throughout the world. In 2010, China attracted USD 108.82 billion in inward foreign direct investment (IFDI), which rose to USD 131.04 billion in 2017 (China Ministry of Commerce, 2017). On the other hand, the Chinese outward foreign direct investment (OFDI) has also increased significantly, from USD 59 billion in 2010 to USD 120.08 billion in 2017[4] (China Ministry of Commerce, 2017). The surging value of both the IFDI and the OFDI made China the world's third largest investment attractor (after the USA and the UK) and the second largest foreign investor (after the USA) in 2016 (UNCTAD, 2016). One of the most significant reasons behind these phenomena is that, in recent years, the Chinese government introduced and revised a series of policies to attract IFDI by optimizing the domestic investing environment and facilitating OFDI by broadening the outward investing channels (described in more detail below).

For foreign investors, it is imperative to know whether Chinese firms provide high-quality financial and non-financial information for economic decision-making. Disclosure of high-quality information can influence capital providers and other stakeholders positively when they are making investments and credit decisions and allocating resources that may enhance the overall capital market efficiency (e.g., Gao, 2003; Healy and Palepu, 2001; Kling and Weitzel, 2011; Weitzel and Berns, 2006). Moreover, the quality of a firm's financial and non-financial information can shape that firm's economic and societal legitimacies, which ensures the firm a better position for attracting foreign investments. As a basic requirement of a firm's economic legitimacy, the quality of its financial information builds the foundation for a firm to exist (Dechow et al., 2010) and allows it to attract capital at a low capital cost (Kim and Sohn, 2013). The quality of non-financial information, in other words, the quality with which and the extent to which a firm discloses corporate social

4 The Chinese annual OFDI reached a peak of USD 170.11 billion in 2016 (China Ministry of Commerce, 2016).

responsibility (CSR) information, provides a firm with societal legitimacy among all of its stakeholders (Gao, 2003; Marquis and Qian, 2014). To enhance the quality of firms' financial and non-financial information, in recent years, the Chinese government has been issuing relevant policies and regulations. Regarding the former, to ensure the quality of financial information, for example, since 2006, the Chinese Ministry of Finance has issued and been continuously revising the *Accounting Standards for Enterprises* (the latest revision was in 2017). As to the latter, the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) and the China Securities Regulatory Commission (CSRC) have issued a series of policies to encourage firms to undertake CSR and issue CSR reports, which are indicators of the quality of the non-financial information. These include such as the *Guidelines on Listed Companies Social Responsibility of Shenzhen Stock Exchange* in 2006, the *Guiding Opinions on Fulfilling Social Responsibilities of Central Enterprises* in 2008, and the *Guidelines on Listed Companies Environmental Information Disclosure of Shanghai Stock Exchange* in 2008.

In addition to the policy changes regarding corporate financial and non-financial reporting for uplifting IFDI, recent Chinese policies have also been leaning toward facilitating OFDI. Among the most influential policies with regional and international impacts, the Belt and Road Initiative (BRI), referring to *The Silk Road Economic Belt and the twenty-first century Maritime Silk Road*, is a top development strategy with very important political and economic implications for both China and the involved countries. It was stipulated in the *Vision and Action on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road*, co-issued by the Chinese National Development and Reform Commission, the Chinese Ministry of Foreign Affairs, and the Chinese Ministry of Commerce, on March 28, 2015, and has been implemented gradually ever since. The Chinese enterprises, in particular, have adopted cross-border mergers and acquisitions (M&As) as a major mechanism of OFDI (Hong and Sun, 2006; Zhang and Ebbers, 2010) and employed international listing as an important channel for raising capital to finance their international expansion, which is supported by the Chinese government's policies under the framework of BRI. The Chinese State Council issued *The Opinions on Further Optimizing the Market for Mergers and Restructuring* in March 2014. This was followed by *The Regulations for Major Assets Restructuring of Listed Companies* and *The Regulations for Mergers and Acquisitions of Listed Companies* revised by the China Securities Regulatory Commission (CSRC) in July 2014. Due to the improved administrative processes, transaction mechanisms, financial support, and payment methods, these new regulations have facilitated cross-border M&As (Weitzel and Berns, 2006). New accounting and taxation policies regarding M&A activities issued by both the Ministry of Finance and the State Administration of Taxation of China, especially in January 2015, have made other means of financing easier.

1.4 Overview and contributions

As mentioned above, in recent years, the Chinese government has issued and revised a series of policies directed toward improving corporate financial and non-financial reporting and promoting cross-border M&As to facilitate FDI. However, since most of these policies are not obligatory, it is unclear whether they work effectively and efficiently. For example, the *Accounting Standards for Enterprises* contain only general guidelines for the quality of accounting information. There are no specific regulations to prevent firms from using earnings management (Chen et al., 2008; Liu and Lu, 2007), which can negatively impact the quality of the corporate financial reporting. This is because, with earnings management, firms can use certain accounting strategies to obscure their true economic performance (Chen and Dai, 2004). As another example, although the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) and the China Securities Regulatory Commission (CSRC) encouraged firms to undertake CSR and issue a CSR report, there are no policies or regulations with specific rules regarding how firms should disclose their CSR information (Chang et al., 2015; Kuo et al., 2012; Xu and Zeng, 2016). Particularly in the Chinese institutional environment, providing high quality reports of financial and non-financial information and conducting cross-border M&As are government-desired activities (e.g., Kling and Weitzel, 2011; Liu and Lu, 2007; Marquis and Qian, 2014; Xu and Zeng, 2016). Given the multiple objectives of political embeddedness, a firm's government or political background could make a difference in interpreting these policies and implementing them in corporate practices. For instance, undertaking CSR might draw negative impacts on corporate financial performance. Because it has to balance between corporate and political interests, a politically embedded firm might face a dilemma in responding to the policy that firms are encouraged to undertake CSR (Marquis and Qian, 2014). Therefore, although interesting to know, it is not yet clear whether and how Chinese firms with different political embeddedness would differ in reacting to such regulative signals.

The above-mentioned examples represent the central theme and research question of the dissertation: How does political embeddedness influence firms' reporting strategies and internationalization? This dissertation aims to identify whether and how political embeddedness (i.e., government ownership and political connections, both at the central and the local level) affects corporate reporting strategies, particularly in light of the recent policy changes regarding the financial and non-financial reporting of firms in China. In addition, this dissertation investigates the effect of political embeddedness on Chinese firms' internationalization strategies, which is particularly interesting considering the recent government programs that were introduced to facilitate Chinese IFDI and OFDI. To achieve this aim, Chapters

2-4 examine the influence of political embeddedness on firms' use of earnings management, CSR reporting, and the propensity to internationalize, respectively.

1.4.1 Chapter 2

Chapter 2 examines whether and how different types and levels of political embeddedness influence the quality of financial reporting in China. This was accomplished by investigating how central and local levels of government ownership and political connections influence the choices of the earnings management strategies of the listed Chinese firms. Using a panel data set of 5,531 publicly traded firms in China, for the years 2009–2013, the results of Chapter 2 demonstrate that government-owned firms, and central government-owned firms in particular, are more likely to substitute accrual-based earnings management with costlier, albeit less detectable, real earnings management strategies than non-government-owned firms. The results of this chapter additionally indicate that, compared to firms without political connections, firms with political connections are more likely to resort to less detectable real earnings management strategies. Although to a lesser extent, these firms are also more likely to increase the use of accrual-based earnings management, indicating a relative substitution effect. The results indicate that, by affecting the trade-off between accrual-based and real earnings management strategies disparately, different types and levels of political embeddedness influence firms' choices of earnings management strategies, and thus the earnings quality.

In considering both accrual-based and real earnings management, Chapter 2 primarily adds to the ongoing research related to the relationship between political embeddedness and financial information quality. Studies of this concern (Beneish, 1997; Braam et al., 2015; Chen et al., 2008; Jeanjean and Stolowy, 2008; Liu and Lu, 2007; McNichols, 2000; Ramanna and Roychowdhury, 2010) have focused mainly on accrual-based earnings management and neglected the potentially more hazardous effects of real earnings management, which might lead to an underestimation of the total effects of earnings management. This chapter thus complements such literature by investigating the relationship between political embeddedness and the choices of both accrual-based and real earnings management strategies among China's listed companies. It thereby provides additional understanding of how political embeddedness may affect the quality of financial reporting.

1.4.2 Chapter 3

By examining whether and how political embeddedness influences the diffusion of corporate social responsibility (CSR) practices in China, Chapter 3 reveals the relationship between political embeddedness and the quality of corporate non-financial information. Specifically, this chapter investigates how government ownership and political connections influence the listed Chinese firms' likelihood of

issuing CSR reports. It also examines the underlying CSR performance (CSRP) and its relationship with the firms' financial performance (CFP). Using the panel data of 15,419 publicly traded firm-year observations in China for the years 2008–2014, the results of this chapter demonstrate that politically embedded firms, particularly firms that are centrally politically embedded, are more likely to issue CSR reports than firms without political embeddedness. The results of this chapter additionally indicate that politically embedded firms, on average, have a higher CSRP than non-politically embedded firms. In addition, the results indicate that, for politically embedded firms, CSRP is more negatively related with financial performance than for firms without political embeddedness. This indicates that political embeddedness also affects the trade-off between CFP and CSRP. This chapter thus provides the first evidence not only on the effectiveness of government-induced CSR policies, but also on their efficiency (i.e., the potential opportunity costs that they imply). The results also demonstrate that different types and levels of political embeddedness play significant, albeit different, roles in explaining the CSR-related practices of firms.

Chapter 3 adds to the organizational theory literature by analyzing how firms strategically react to government signals. Specifically, this chapter analyzes the potential opportunity costs that adhering to the governmental signals regarding CSR imply, thus shifting the focus from a pure analysis of the effectiveness of governmental CSR initiatives to a more efficiency-oriented perspective, which also considers how political embeddedness influences the relationship between CFP and CSRP. By examining the political drivers of the diffusion of firms' CSR-related practices, Chapter 3 additionally complements the non-financial reporting literature that frequently focuses on the business and societal drivers of corporate social responsibility (Moon, 2004).

1.4.3 Chapter 4

Cross-border M&As are a dominant form of FDI and linked closely to internationalization strategies (Kling et al., 2014; Shimizu et al., 2004). Since cross-border M&As are government-supported investment activities, it is important to identify the roles that political embeddedness play in influencing firms' internationalization strategies with regard to the government's relevant policy changes. Chapter 4 is dedicated to responding to this call and investigating whether and how political embeddedness influences firms' propensity for conducting cross-border M&As and their success in China. I contend that institutional constraints, and consequential resource allocation and industry traits influence both politically embedded enterprises and firms without political embeddedness. Therefore, building on prior theories over international business, I developed a theoretical Chinese specific "strategy tripod" framework centered on an institution-based perspective and incorporating resource- and industry-based views. Using a panel data set with

30,314 firm-year observations of publicly traded firms in China from 2000 to 2015, the results demonstrate that state-owned enterprises (SOEs) conduct fewer cross-border M&As than non-SOEs. Compared with non-SOEs, SOEs benefit less from M&A activities. The level of government ownership matters, in that central SOEs conduct more cross-border M&As and benefit more from M&A activities than local SOEs. The results additionally indicate that political connections do not play a significant role in explaining a firm's propensity for conducting cross-border M&As or M&A success. The findings in Chapter 4 indicate that different types and levels of political embeddedness in China influence firms' propensity for conducting cross-border M&As and M&A success differently.

Chapter 4 primarily extends the international business literature by analyzing the institutional determinants of M&A success and the propensity of Chinese acquirers for going abroad. In this sense, this chapter extends Kling and Weitzel (2011) by demonstrating that a firm's political embeddedness, especially local political embeddedness, has a negative impact on both the firm's internationalization and on its M&A performance. This chapter also identifies government ownership as the main channel through which the government exerts influence on the internationalization strategy of firms.

1.4.4 Contributions

Alongside the specific contributions that each chapter makes to the literature (see above), this dissertation additionally provides more general contributions across all of the chapters. The literature on the effects of political embeddedness on corporate affairs examines either government ownership (Wei and Varela, 2003; Wei et al., 2005; Wu et al., 2012a; Xu and Wang, 1999) or the political connections of the executives (Fan et al., 2007; Li et al., 2008; Tu et al., 2013; Wu et al., 2012c). However, a singular focus on either government ownership or political connections underestimates the total impact of political embeddedness. Therefore, applying a more comprehensive measure of political embeddedness is one of the more general contributions of this dissertation. The studies in Chapters 2–4 add to the literature by using government ownership and political connections as proxies for the total political embeddedness of the firms.

In addition, this dissertation considers different levels of political embeddedness. Since different levels of the Chinese political system have different characteristics, and can thus have different effects on corporate affairs, this is particularly useful in the Chinese context. For example, as I found in Chapter 2, firms with a local level of political embeddedness are more likely to resort to real earnings management than their peers with central political embeddedness. These firms are also less likely to issue CSR reports and undertake CSR (Chapter 3) and they have a lower tendency to internationalize and create value from M&As as well (Chapter 4). The differentiation

between the central and the local levels in both government ownership and political connections thus makes it possible to present a more fine-tuned picture of the mechanisms behind the effects of political embeddedness on corporate strategies.

Another contribution of this dissertation is that it provides empirical evidence for corporate finance-related research in an emerging market. Studies on the influential factors of earnings management strategies (Braam et al., 2015; Cohen and Zarowin, 2010; Dechow et al., 2010), CSR reporting strategies (Baldini et al., 2016; Braam et al., 2016; Delmas and Toffel, 2004), and internationalization strategies (Bamiatzi et al., 2015; Fuentelsaz et al., 2015; Kling et al., 2014) are conducted primarily in developed and mature markets. There has been little systematic evidence of firms using the two earnings management strategies as substitutes for their CSR practices or their internationalization activities in the context of emerging markets, such as China. Due to its special transitional phase and institutional background, China provides both an appropriate and a more interesting setting for investigating the influential factors of corporate strategies. Overall, the studies of this dissertation enrich the findings regarding the effects of political embeddedness on corporate strategies in emerging markets.

1.4.5 Policy relevance

The results of this dissertation have several important policy implications for accounting, CSR, and M&A practices. First, the findings suggest that new or revised policies should be tailored according to a firm's political embeddedness. The conclusion that both government ownership and political connections play considerable but different incremental roles in explaining the variance in the choices of corporate financial strategies requires policy-makers to consider the influence of firm ties with the government and make tailored policies governing the micro-economy. Specifically, such policies should make a distinction between firms with and without government ownership and firms with and without political connections. This could be especially useful when certain government-induced policies are encouraging but not binding, such as CSR practices-related and M&A-related policies in the Chinese setting. For example, Chapter 3 finds that firms without political embeddedness are less likely to issue CSR reports, and tend to have lower CSR performances than politically embedded firms. Accordingly, CSR-related policies should pay particular attention to firms without political embeddedness, and could add more stimuli to such firms for a better CSR practice.

Second, instead of describing general ideas, policies should be formulated and revised to be directed toward solving specific problems. Since the central and the local levels of political embeddedness draw different influences on corporate financial strategies, the effectiveness of policies could be enhanced if policy-makers take the levels of political embeddedness into consideration. Chapter 3, for instance,

shows that firms with central political embeddedness are more likely to issue CSR reports than firms with local political embeddedness. Therefore, CSR-related policies should target the local levels of politically embedded firms by stipulating tougher guidelines or offering stronger stimuli for the local firms. As shown in the findings in Chapter 2, the local level of political embeddedness plays considerably more roles in influencing the choices for earnings management strategies and thus draws deeper degrees of worsening effects on financial information quality. Therefore, when revising related regulations, such as the *Accounting Standards for Enterprises,* it would be better if policy-makers could recognize such negative effects and make different specifications for firms that have different levels of political embeddedness. In Chapter 4, I found that the negative effect of local government on firms' propensity for conducting cross-border M&As as well as on M&A success is much stronger than that of the central government. By rectifying the general practice that all kinds of government ownership are treated uniformly and suggesting that the national governance in emerging economies should focus on the reformation of local government, this finding optimizes the orientation of the reformation for policy makers of developing countries such as China.

Third, policy makers should also direct attention to the potential policy costs alongside the policy benefits. For instance, on top of the indication that different types and levels of dependency on the government in China is an important driver of the diffusion of corporate CSR practices, the findings in Chapter 3 also emphasize the necessity of considering the policy-related opportunity costs. If the improvement of the CSRP and the number of firms that publish CSR reports comes at the cost of a significantly decreasing CFP, the net societal benefit may become negative, rendering the policy unfavorable. Therefore, how to minimize the opportunity cost that political embeddedness draws on the listed Chinese firms' CSR practices should be listed on the policy-makers' agenda.

Please note that the following chapters in this thesis include their own introduction and conclusion and are as such self-contained. However, the different appendices to these chapters are found at the very end of this thesis (but before the biography and Dutch summary). The reference list is presented after the final chapter.


EM

Chapter 2

Firms' political embeddedness and the choice of earnings management strategies in China[5]

5 This chapter is based on a joint paper with Geert Braam, Daniel Reimsbach and Utz Weitzel, *Firms' Political Embeddedness and the Choice of Earnings Management Strategies in China*. Current status: under review.

2.1 Introduction

As the world's largest emerging stock market, China has been playing an increasingly important role in the global economy (Chen et al., 2011b). For investors in the Chinese stock market, it is important to know whether Chinese listed firms provide high-quality financial information for economic decision making. Disclosure of high-quality information can positively influence capital providers and other stakeholders when they are making investments and credit decisions and allocating resources that may enhance overall capital market efficiency. However, an important structural aspect of the Chinese stock market, which distinguishes it from its Western peers, is the political embeddedness of many companies (Lee et al., 2014). Political embeddedness refers to firms that have strong government ties, either via state ownership or via political network connections (Chen et al, 2011; Marquis and Qian, 2014). Although many Chinese firms have been transformed from government entities to publicly traded companies, both dimensions of political embeddedness are likely to continue to influence these firm's corporate policies. The government often remains the majority shareholder, and thus maintains ownership (Wang et al., 2008b). Via de facto control of these firms (i.e., the ability to direct a company to act on the government's behalf), the government can directly influence corporate policies (Chen et al., 2011b; Wu et al., 2012a). Furthermore, due to the appointment of top executives by the government, and the executives' pursuit of positions in the political system, extensive political connections between the government and the senior management of large firms are still very common, which is likely to influence Chinese politically connected firms' corporate policies indirectly. However, it is unclear how and to what extent this political embeddedness affects the quality of corporate financial reporting in China (Fan et al., 2007; Lee et al., 2014; Li et al., 2008; Wu et al., 2012b).

An important indicator of corporate financial reporting quality is the extent to which firms use so-called earnings management strategies to obscure the firms' true economic performance. Firms can use multiple earnings management strategies to manage their earnings, most importantly accrual-based and real earnings management (Anagnostopoulou and Tsekrekos, 2017; Badertscher, 2011; Braam et al., 2015). Accrual-based earnings management occurs when managers choose accounting policies from a set of generally accepted policies to achieve earnings objectives (Dechow and Skinner, 2000). When using real earnings management, however, companies deviate from normal business practices by altering the timing or structuring of real business transactions to meet or beat earnings targets (Roychowdhury, 2006). Unlike accrual-based earnings management, real earnings management has direct cash flow consequences (Alhadab et al., 2015), as well as potential economic consequences for a firm's long-term value (Gunny,

2010). Therefore, real earnings management strategies are considered costly (Ipino and Parbonetti, 2017) and more difficult to detect than accrual-based earnings management (Alhadab et al., 2015; Badertscher, 2011; Graham et al., 2005; Gunny, 2010). For a comprehensive understanding of firms' choices of earnings management, both dimensions need to be included at the same time because evidence shows that firms use the two earnings management strategies as substitutes (Badertscher, 2011; Braam et al., 2015; Cohen et al., 2008; Cohen and Zarowin, 2010; Zang, 2012). Therefore, this study considers both dimensions of earnings management as well as potential substitution effects when investigating the influence of political embeddedness on the choice of earnings management strategies, and thus corporate financial reporting quality.

Using a panel data set of 5,531 publicly traded firms in China from 2009 to 2013, our results indicate that government-owned firms, especially firms owned by the central government, are more likely to substitute costly but less detectable real activities manipulation for accrual-based earnings management than non-government-owned firms, after controlling for other incentives for earnings management. The results also indicate that the trade-off between real and accrual-based earnings management strategies differs between firms with and without political connections. Compared to non-connected firms, firms with political connections are more likely to use real earnings management strategies. However, these firms are also more likely to increase the use of accrual-based earnings management, although to a lesser extent than real earnings management, indicating a relative substitution. Collectively, the results indicate that political embeddedness is negatively related to Chinese listed firms' earnings quality, and thus, the quality of financial reporting. However, different types and levels of political embeddedness play different incremental roles in explaining the variance in the choices for earnings management strategies.

By addressing the two dimensions of both political embeddedness and earnings management simultaneously, this study contributes to the related literature in several ways. First, current studies of the relationship between political embeddedness and earnings management have mostly focused on only one aspect of both concepts. Ramanna and Roychowdhury (2010), for example, examine the influence of political connections on accrual-based earnings management using data from US firms but neglect the influence of government ownership, as well as the potentially more hazardous consequences of real earnings management. Chen et al. (2008), on the other hand, address the effects of government ownership (via subsidies) on earnings management but in turn do not include political connections into their analysis and they do not differentiate between real and accrual-based earnings management strategies. Braam et al. (2015), finally, incorporate both dimensions of earnings management, but they focus solely on the influence of political connections and again do not account for government ownership.

Second, the few studies that incorporate both dimensions of political embeddedness do not at all address the issues of financial reporting quality in general and earnings management in particular (Chen et al., 2011b; Marquis and Qian, 2014). Overall, no studies exist that address both dimensions of both concepts simultaneously. A singular focus on either government ownership or political connections underestimates the total effects of political embeddedness on corporate financial reporting behavior, and solely addressing either accrual-based or real earnings management neglects the potential hazardous consequences of the other type of earnings management. Studying the different dimensions of political embeddedness and earnings management in parallel will contribute to a better understanding of the relationship between political embeddedness and firms' choices of earnings management strategies, and to more robust conclusions.

Third, the substitution effect between accrual-based and real earnings management has mainly been investigated in the context of developed markets (Badertscher, 2011; Braam et al., 2015; Cohen et al., 2008; Cohen and Zarowin, 2010; Zang, 2012). Little systematic evidence of firms' using the two earnings management strategies as substitutes exists in the context of emerging markets, such as China.

Taking all these aspects into account, this study analyzes how the two dimensions of political embeddedness affect listed firms' choices of the two earnings management strategies and their potential substitution, using the Chinese setting.

The remainder of this paper is structured as follows. First, we present a review of the related literature and develop hypotheses. Next, we describe the research method and then present the results. Finally, we discuss and provide conclusions regarding the results and indicate directions for further research.

2.2 Literature review and hypotheses

Firms can utilize multiple earnings management strategies, that is, accrual-based and real earnings management, to manage their earnings (Anagnostopoulou and Tsekrekos, 2017; Badertscher, 2011; Braam et al., 2015; Cohen and Zarowin, 2010; Dechow et al., 2010; Zang, 2012). Accrual-based earnings management occurs when managers aim to obscure true economic performance by changing accounting methods or estimates within the generally accepted accounting principles (Dechow and Skinner, 2000). In contrast, real earnings management occurs when managers undertake actions that adapt the timing or structuring of real operations and that deviate from normal business practices, such as manipulating sales, reducing discretionary expenditures, and overproducing inventories to decrease the costs of goods sold, with the primary objective of meeting or beating certain earnings thresholds (Roychowdhury, 2006). Real activities manipulation and accrual-based

earnings management are both costly (Anagnostopoulou and Tsekrekos, 2017; Zang, 2012). However, real earnings management, as a departure from optimal operational decisions (Zang, 2012), is, in general, considered costlier than accrual-based earnings management (Graham et al., 2005; Ipino and Parbonetti, 2017; Kim and Sohn, 2013). Unlike accrual-based earnings management, real earnings management has direct cash flow consequences (Alhadab et al., 2015), which may also have detrimental economic impacts on firms' long-term value (Gunny, 2010; Zang, 2012). In contrast, real earnings management is more difficult to detect than accrual-based earnings management (Alhadab et al., 2015; Graham et al., 2005), because real activities manipulation is usually not under the jurisdiction of any existing auditing system, and is less subject to extensive controls and external monitoring by society, including scrutiny by the media, government and political parties (Braam et al., 2015; Kim and Sohn, 2013; Roychowdhury, 2006).

Darrough and Rangan (2005) argue that the greatest effect of accrual-based and real earnings management would be attained through the coordinated use of both tools. Managers of firms are aware of the rewards of meeting or beating earnings targets, which motivates the managers to choose among the alternative earnings management strategies (Anagnostopoulou and Tsekrekos, 2017; Bartov et al., 2002). In situations in which both earnings management methods can be utilized, managers are thus likely to trade off between the two earnings management strategies based on their relative costs and benefits (Cohen et al., 2008; Cohen and Zarowin, 2010; Ewert and Wagenhofer, 2005; Zang, 2012).

However, a firm's political embeddedness may influence this cost-benefit analysis and thus, the likelihood of trading off between the two strategies. For government-owned firms, the detection of low-quality reporting is very costly. In China, government-owned firms are meant to be symbols of the economy's reliability and stability. Their reputation, which is directly related to the image of the Chinese government itself, is supposed to be positive and affirmative. Earnings management detection might damage a firm's reputation, as well as the public image of the corresponding government. In addition, government-owned firms have more resources to deal with the risks inherently involved in the use of real earnings management. Due to the ownership ties with the government, these firms have better access to valuable resources through the government's political and financial support (Brandt and Li, 2003; Li and Zhou, 2005; Qian, 1994; Wu et al., 2012c).[6] For these reasons, the opportunity cost of using accrual-based earnings management is higher than that of using real earnings management for government-owned firms. Thus, government-owned firms should be more inclined to utilize real earnings

6 For example, they get easier access to debt financing and lower taxation (Claessens et al., 2008; Faccio, 2010; Goldman et al., 2013; Johnson & Mitton, 2003; Khwaja & Mian, 2005), have preferential access to government contracts (Goldman et al., 2009), or obtain benefits from regulatory protection (Kroszner & Stratmann, 1998).

management strategies which is less likely to be detected (Chaney et al., 2011; Braam et al., 2015; Faccio, 2006; Faccio et al., 2006).

Overall, we thus expect that for government-owned firms in China the marginal benefits of using real earnings management strategies are likely to outweigh the marginal costs. Real earnings management strategies help these firms to mask political favors from the government and offer the firms a relative advantage of high opacity with a lower likelihood of detection (Chaney et al., 2011; Faccio, 2006; Faccio et al., 2006). The cost-benefit structure of trading off real for accrual-based earnings management is thus different from that of non-government-owned firms. Therefore, we hypothesize:

Hypothesis 1a: Government-owned firms are more likely to substitute real earnings management for accrual-based earnings management than non-government-owned firms.

However, in China, the regulatory environment for firms owned by the central government differs from that for firms owned by local governments (Wang et al., 2008b). Central government–owned firms are subjected to more effective regulation and strict supervision by supervisory and regulatory institutions, such as the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) and the China Securities Regulatory Commission (CSRC), because of the firms' crucial roles in the Chinese economy (Chen et al., 2004; Sun et al., 2002). Furthermore, to maintain the central government's positive reputation, firms owned by the central government are more likely to choose higher-quality auditors (Wang et al., 2008b). Therefore, detection of low-quality reporting may damage not only the reputation of the firms owned by the central government and their managers but also that of the central government. In addition, the resource endowment and market status of central and local government–owned firms are different (Wang et al., 2008b; Wu et al., 2012a). Although local and central government–owned firms operate in the same industry, firms owned by the central government are usually leading conglomerates in the market with their larger control power of resources and support from the central government (Chen et al., 2004; Sun et al., 2002; Wang et al., 2008b). Such privileges enable centrally government-owned firms to better deal with the risks inherently involved in the use of real earnings management. For these reasons, the incentives for central government–owned firms to trade off real for accrual-based earnings management should be stronger than those for local government–owned firms. Thus, we hypothesize:

Hypothesis 1b: The effect of substituting real earnings management for accrual-based earnings management is stronger for firms owned by the central government than for firms owned by local governments.

In addition to government ownership, extensive political connections between the government and companies' senior management are common in China. There are many examples in which corporate executives are local or central government officials themselves (Ma and Parish, 2006; Marquis and Qian, 2014). These political connections may also influence firms' choices of earnings management strategies and thus affect the earnings quality (Braam et al., 2015; Chaney et al., 2011) because politically connected managers have strong incentives and opportunities to pursue financial benefits and to achieve political and personal objectives, such as promotion and increased remuneration (Li and Zhou, 2005; Shleifer and Vishny, 1994). Politically connected firms may thus, for example, try to hide or obscure the gains that the firms typically derive from their connections, because detection may damage the firms' reputation, as well as the social image of the connected political party or politician (Chaney et al., 2011; Faccio, 2006; Faccio et al., 2006). In addition, detection may result in opportunity costs when a firm loses its privileged access to the benefits of political connections (Burton et al., 2011; Hay and Shleifer, 1998). Furthermore, as politically connected firms derive benefits from political connections, such as easier access to bank loans (Boubakri et al., 2008; Khwaja and Mian, 2005; Li et al., 2008), favorable regulatory treatment (Agrawal and Knoeber, 2000) and bailouts (Faccio et al., 2006), these firms are more capable of dealing with operational risks caused by using real earnings management. Taken together with the lower likelihood of detection, real earnings management strategies thus are also more attractive to politically connected firms. Therefore, we expect these firms to trade off real for accrual-based earnings management as well. Picking up on our previous arguments, the incentives to trade off real for accrual-based earnings management should again be stronger for firms with political connections to the central government than for firms with political connections to a local government. Therefore, we offer the following two hypotheses:

Hypothesis 2a: Firms with political connections are more likely to substitute real earnings management for accrual-based earnings management than firms without political connections.

Hypothesis 2b: The effect of substituting real earnings management for accrual-based earnings management is stronger for firms with central political connections than for firms with local political connections.

2.3 Research method

2.3.1 Sample selection and descriptive statistics

To test the hypotheses, we used data for the Main Board A share public listed companies (PLCs) of the Shanghai and Shenzhen stock exchanges for 2009–2013. Consistent with Xia and Fang (2005), we excluded listed firms that had B shares or H shares. These firms are regulated by Chinese mainland and overseas (or Hong Kong) laws and regulations, which could bias the results. We also excluded financial companies and firms for which it was not clear who ultimately has de facto control. For inclusion in our sample, we required that all financial and non-financial information was available. This information was extracted from the Datastream and CSMAR databases, which contain historical financial data from the annual reports of Chinese listed companies. Data on government ownership were manually collected from annual reports of the companies selected. The CSRC requires listed companies disclose specific information on their de facto control in the firms' annual reports. To collect data on political connections, the resumes of directors, supervisors, and managers (DSMs) were examined.

After we omitted missing observations, the remaining unbalanced panel data set includes 5,531 firm-year observations for 2009–2013. Table 2.1 presents the descriptive statistics of the sample firms. Panel A shows the yearly distribution of the sample firms across industries. Panels B, C, and D present the distribution of the firm's government ownership and political connections across years, industries, and regions.

2.3.2 Variables

2.3.2.1 Measurement of real and accrual-based earnings management

The dependent variables are proxies for real and accrual-based earnings management.[7] Following previous literature (Braam et al., 2015; Cohen et al., 2008; Cohen and Zarowin, 2010; Gunny, 2010; Roychowdhury, 2006; Zang, 2012), we used abnormal levels of cash flows from operations (RM_CFO), abnormal levels of production costs (RM_PROD), and abnormal levels of discretionary expenses (RM_DISX) as proxies for real earnings management.[8] To calculate the proxies for real earnings management, consistent with previous research (Cohen and Zarowin,

7 Unfortunately, due to copyright issues, the calculated values of real and accrual-based earnings management of each firm-year observation cannot be shared. However, all transformed data and computations used for the analyses are available on request by the authors.

8 Abnormal levels of cash flows from operations (RM_CFO) are a result of the acceleration of the timing of sales through increased price discounts or more lenient credit terms. Abnormal levels of production costs (RM_PROD) occur through overproduction of inventory, resulting in a lower fixed cost per unit sold and a reduction of cost of goods sold. Abnormal levels of discretionary expenses (RM_DISX) are generated as a result of cutting discretionary expenses, such as advertising, research and development, and administrative (SG&A) expenses.

2010; Dechow et al., 1995; Dechow et al., 1998; Roychowdhury, 2006), for each metric, we first used the following cross-sectional regression analysis and estimated parameters that allow calculation of the normal levels of cash flows from operations, production costs, and discretionary expenses, using the following equations:

$$\frac{CFO_{it}}{ASSETS_{it-1}} = \beta_0 + \beta_1 \frac{1}{ASSETS_{it-1}} + \beta_2 \frac{SALES_{it}}{ASSETS_{it-1}} + \beta_3 \frac{\Delta SALES_{it}}{ASSETS_{it-1}} + \varepsilon_{it} \ , \quad (1)$$

$$\frac{PROD_{it}}{ASSETS_{it-1}} = \beta_0 + \beta_1 \frac{1}{ASSETS_{it-1}} + \beta_2 \frac{SALES_{it}}{ASSETS_{it-1}} + \beta_3 \frac{\Delta SALES_{it}}{ASSETS_{it-1}} + \beta_4 \frac{\Delta SALES_{it-1}}{ASSETS_{it-1}} + \varepsilon_{it} \ , \quad (2)$$

$$\frac{DISX_{it}}{ASSETS_{it-1}} = \beta_0 + \beta_1 \frac{1}{ASSETS_{it-1}} + \beta_2 \frac{\Delta SALES_{it}}{ASSETS_{it-1}} + \beta_3 \frac{SALES_{it}}{ASSETS_{it-1}} + \varepsilon_{it} \ , \quad (3)$$

where CFO_{it} is the net cash receipts and disbursements resulting from the operations of firm i in year t; $ASSETS_{it-1}$ is the total assets of firm *i* at the end of year *t*–1; $SALES_{it}$ is the net sales of firm *i* in year *t*; $\Delta SALES_{it}$ is the change in net sales from year *t*–1 to t of firm *i*; $PROD_{it}$ is the cost of goods sold by firm i in year t; and $DISX_{it}$ is discretionary expenses, computed as the sum of selling, general, and administrative expenses (SG&A) and research and development (R&D) expenses. Given sales levels, firms that engage in real earnings management exhibit one or more of the following characteristics: abnormally low cash flows from operations, abnormally high production costs, and/or abnormally low discretionary expenses.

Second, consistent with Roychowdhury (2006), the differences between the actual levels and the estimated normal levels, that is, the residuals, were considered the abnormal levels of cash flows from operations, production costs, and discretionary expenses.

Table 2.1: Descriptive statistics for sample firms (2009-2013)

Panel A: Distribution of observations in terms of industries and years

	2009		2010		2011		2012		2013		Total	
	N	%	N	%	N	%	N	%	N	%	N	%
Industry	670	0.63	689	0.63	717	0.64	722	0.64	725	0.64	3523	0.64
Real estate	126	0.12	127	0.12	130	0.12	128	0.11	128	0.11	639	0.12
Commercials	102	0.10	106	0.10	107	0.10	106	0.09	107	0.09	528	0.10
Comprehensive	42	0.04	42	0.04	43	0.04	42	0.04	42	0.04	211	0.04
Public Utility	118	0.11	125	0.11	129	0.11	130	0.12	128	0.11	630	0.11
Total	1058	1.00	1089	1.00	1126	1.00	1128	1.00	1130	1.00	5531	1.00

Panel B: Yearly distribution of government ownership and political connections

	Government ownership (GO)										Political connections (PC)									
	Central GO		Local GO		Total GO		No GO		Total		Central PC		Local PC		Total PC		No PC		Total	
	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%
2009	229	0.32	497	0.68	726	0.69	332	0.31	1058	0.19	225	0.52	210	0.48	435	0.41	623	0.59	1058	0.19
2010	238	0.32	499	0.68	737	0.68	352	0.32	1089	0.20	233	0.53	205	0.47	438	0.40	651	0.60	1089	0.20
2011	240	0.33	490	0.67	730	0.65	396	0.35	1126	0.20	448	0.53	397	0.47	845	0.75	281	0.25	1126	0.20
2012	237	0.33	490	0.67	727	0.64	401	0.36	1128	0.20	488	0.57	368	0.43	856	0.76	272	0.24	1128	0.20
2013	230	0.32	489	0.68	719	0.64	411	0.36	1130	0.20	500	0.58	363	0.42	863	0.76	267	0.24	1130	0.20
Total	1174	0.32	2465	0.68	3639	0.66	1892	0.34	5531	1.00	1894	0.55	1543	0.45	3437	0.62	2094	0.38	5531	1.00

Panel C: Industrial distribution of government ownership and political connections

	Government ownership										Political connections									
	Central GO		Local GO		Total GO		No GO		Total		Central PC		Local PC		Total PC		No PC		Total	
	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%
Industry	869	0.36	1520	0.64	2389	0.67	1188	0.33	3577	0.65	1370	0.56	1087	0.44	2457	0.69	1120	0.31	3577	0.65
Real estate	93	0.25	282	0.75	375	0.57	287	0.43	662	0.12	175	0.54	150	0.46	325	0.49	337	0.51	662	0.12
Commercials	54	0.17	260	0.83	314	0.59	214	0.41	528	0.10	136	0.55	113	0.45	249	0.47	279	0.53	528	0.10
Comprehensive	20	0.17	97	0.83	117	0.62	71	0.38	188	0.03	45	0.45	55	0.55	100	0.53	88	0.47	188	0.03
Public Utility	138	0.31	306	0.69	444	0.77	132	0.23	576	0.10	168	0.55	138	0.45	306	0.53	270	0.47	576	0.10
Total	1174	0.32	2465	0.68	3639	0.66	1892	0.34	5531	1.00	1894	0.55	1543	0.45	3437	0.62	2094	0.38	5531	1.00

Panel D: Regional distribution of government ownership and political connections

	Government ownership										Political connections									
	Central GO		Local GO		Total GO		No GO		Total		Central PC		Local PC		Total PC		No PC		Total	
	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%	N	%
North	356	0.51	347	0.49	703	0.78	200	0.22	903	0.16	393	0.74	138	0.26	531	0.59	372	0.41	903	0.16
North East	100	0.38	166	0.62	266	0.63	154	0.37	420	0.08	136	0.58	99	0.42	235	0.56	185	0.44	420	0.08
East	270	0.23	892	0.77	1162	0.62	724	0.38	1886	0.34	559	0.50	553	0.50	1112	0.59	774	0.41	1886	0.34
Center	157	0.33	326	0.67	483	0.73	178	0.27	661	0.12	259	0.53	227	0.47	486	0.74	175	0.26	661	0.12
South	91	0.25	271	0.75	362	0.54	305	0.46	667	0.12	203	0.48	220	0.52	423	0.63	244	0.37	667	0.12
South West	115	0.32	246	0.68	361	0.64	207	0.36	568	0.10	215	0.55	178	0.45	393	0.69	175	0.31	568	0.10
North West	85	0.28	217	0.72	302	0.71	124	0.29	426	0.08	129	0.50	128	0.50	257	0.60	169	0.40	426	0.08
Total	1174	0.32	2465	0.68	3639	0.66	1892	0.34	5531	1.00	1894	0.55	1543	0.45	3437	0.62	2094	0.38	5531	1.00

To capture the aggregate effects of real earnings management, consistent with Braam et al. (2015), Cohen et al. (2008), Cohen and Zarowin (2010), Ipino and Parbonetti (2017) and Zang (2012), we combined the three individual real earnings management measures to compute three comprehensive metrics of real activities manipulation. For the first measure, we multiplied the standardized variables of abnormal cash flows from operations (RM_CFO) and abnormal discretionary expenses (RM_DISX) by negative one (so that the higher the amounts, the more likely it is that the firm is engaged in sales manipulation and cutting discretionary expenses) and then aggregated them into one measure (RM_CD). For the second measure, we added the standardized variable of abnormal discretionary expenses multiplied by negative one to the standardized variable of abnormal production costs (RM_PROD). The higher this aggregate measure (RM_PD), the more likely the firm is engaged in cutting discretionary expenses and production manipulation. For the third measure, we computed the sum of the standardized variables of abnormal cash flows from operations and abnormal discretionary expenses, multiplied by negative one, and the standardized variable of abnormal production costs (RM_CPD). The higher this aggregate measure, the more likely the firm is engaged in real activities manipulation.

Following previous literature, we used two estimations of discretionary accruals to proxy accrual-based earnings management by using the cross-sectional Jones model (Cohen et al., 2008; Cohen and Zarowin, 2010; Dechow et al., 1995; Ipino and Parbonetti, 2017) and cash-flow-adjusted model (Ball and Shivakumar's, 2006; Bruynseels and Cardinaels, 2014), as follows:

$$\frac{\mathrm{TA_{it}}}{\mathrm{ASSETS_{it-1}}} = \beta_0 + \beta_1 \frac{1}{\mathrm{ASSETS_{it-1}}} + \beta_2 \frac{\Delta\mathrm{SALES_{it}}}{\mathrm{ASSETS_{it-1}}} + \beta_3 \frac{\mathrm{PPE_{it}}}{\mathrm{ASSETS_{it-1}}} + \varepsilon_{it} \ , \qquad (4)$$

$$\frac{\mathrm{TA_{it}}}{\mathrm{AVA_{it}}} = \beta_0 + \beta_1 \frac{\Delta\mathrm{S_{it}}}{\mathrm{AVA_{it}}} + \beta_2 \frac{\mathrm{PPE_{it}}}{\mathrm{AVA_{it}}} + \beta_3 \frac{\mathrm{CFO_{it}}}{\mathrm{AVA_{it}}} + \beta_4 \mathrm{DCFO_{it}} + \beta_5 \frac{\mathrm{CFO_{it}}}{\mathrm{AVA_{it}}} * \mathrm{DCFO_{it}} + \varepsilon_{it} \ , \qquad (5)$$

where TA_{it} is the total accruals of firm i in year t, measured by the earnings before extraordinary items and discontinued operations minus the cash flows from operations (Hribar and Collins, 2002); PPE_{it} is the net value of property, plant and equipment of firm i in year t; AVA_{it} is the average total assets for firm i in year t and t–1; $DCFO_{it}$ is a dummy variable that equals 1 if the cash flow from operations is negative, and 0 otherwise. Consistent with Cohen et al. (2008), the absolute values of the residuals serve as the proxies for accrual-based earnings management. We use the absolute value, because it also captures accrual reversals following earnings management. Next, following Braam et al. (2015), we computed a composite metric of accrual-based earnings management as the sum of the standardized variables of the two individual measures of accrual-based earnings management, divided by two.

Finally, as a proxy of substitution, we calculated the RM-AM ratio, computed as RM_CD, RM_PD and RM_CPD divided by AM. In addition, and consistent with Braam et al. (2015), we developed composite measures to assess a firm's use of diametrically opposing combinations of accrual-based and real earnings management strategies, which could be an indication of a substitution of real earnings management for accrual-based earnings management. $AM_{Low}RM_{High}$ is a dummy coded 1 if the value of RM_CPD firm i in year t is above the industry-year median[9] and AM below the industry median, and 0 otherwise, indicating firms that choose a high level of real earnings management (RM_{High}) combined with low levels of accrual-based earnings management (AM_{Low}). Similarly, $AM_{High}RM_{Low}$ is a dummy that indicates firms with high levels of accrual-based earnings management and low levels of real earnings management. $AM_{High}RM_{High}$ and $AM_{Low}RM_{Low}$ indicate firms with high/low levels of accrual-based earnings management and real earnings management.

To remove the problem of extreme outliers in some continuous variables, we winsorized all earnings management variables at the 1% and 99% percentile of their distribution to "avoid extreme observations due to noisy estimation" (Zang, 2012: p.689). Table 2.2, which summarizes the definitions of the dependent, independent, and control variables employed in our analyses, describes the calculations of the comprehensive metrics used to proxy real and accrual-based earnings management.

Table 2.2: Variable definitions

Variables	Definition
AM_MJ	Proxy of accrual-based earnings management estimated by discretionary accruals using the Modified Jones Model (Cohen et al., 2008; Cohen and Zarowin, 2010; Dechow et al., 1995).
AM_BS	Proxy of accrual-based earnings management estimated by discretionary accruals using the Ball and Shivakumar Model (2006), which controls for the asymmetric timeliness of accruals in recognizing economic gain and loss (Ball and Shivakumar, 2006; Bruynseels and Cardinaels, 2014).
AM	Composite measurement of accrual-based earnings management, computed as the sum of the standardized absolute value of discretionary accruals computed using the Modified Jones Model (AM_MJ) and the standardized absolute value of discretionary accruals computed using the cash-flow-adjusted model of Ball and Shivakumar (AM_BS), divided by two.
RM_CFO (R)	The reversed level of abnormal cash flows from operations.

9 A practical justification for the use of this cut-off point is that it splits the sample into two groups of equal size. This grouping eliminates potential small sample and selection biases that may occur when, for example, the average is used as a cut-off point. In the robustness section, we also use alternative cut-off points to check whether the cut-off at the median may have driven our results; that is, we repeat the analyses using the top 25% and 10% of the sample. The results of the additional tests show that segmentation of firms with and without earnings management at different levels do not change the results qualitatively, suggesting that the results are robust to different cut-off levels.

Table 2.2: Continuation

Variables	Definition
RM_PROD	The level of abnormal production costs, where production costs are defined as the sum of the cost of goods sold.
RM_DISX (R)	The reversed level of abnormal discretionary expenses, where discretionary expenses are the sum of R&D expenses and SG&A expenses.
RM_CD	Comprehensive metric of real activities' manipulation, computed as the natural logarithm of the sum of the standardized variables of RM_CFO and RM_DISX multiplied by negative one, divided by two.
RM_PD	Comprehensive metric of real activities' manipulation, computed as the natural logarithm of the sum of the standardized variable of RM_PROD and the standardized variable of RM_DISX multiplied by negative one, divided by two.
RM_CPD	Comprehensive metric of real activities' manipulation, computed as the natural logarithm of the sum of the standardized variable of RM_PROD and the standardized variables of RM_CFO and RM_DISX multiplied by negative one, divided by three.
RM/AM	RM-AM ratio, computed as RM_CD, RM_PD and RM_CPD respectively divided by AM.
$AM_{LOW}RM_{HIGH}$	AM and RM combination dummy. The value is 1 if AM is lower than the industrial median and RM is higher than the industrial median.
$AM_{HIGH}RM_{LOW}$	AM and RM combination dummy. The value is 1 if AM is higher than the industrial median and RM is lower than the industrial median.
$AM_{HIGH}RM_{HIGH}$	AM and RM combination dummy. The value is 1 if AM is higher than the industrial median and RM is higher than the industrial median.
$AM_{LOW}RM_{LOW}$	AM and RM combination dummy. The value is 1 if AM is lower than the industrial median and RM is lower than the industrial median.
GOV	Government ownership dummy. The value is 1 if the ultimate owner of a firm is the government; 0 otherwise. The government has ultimate ownership if it holds the most shares directly and indirectly.
NONGOV	Non-government ownership dummy. The value is 1 if the ultimate owner of a firm is not the government; 0 otherwise.
LOCGOV	Local government ownership dummy. The value is 1 if the ultimate owner of a firm is local government; 0 if the ultimate owner of a firm is the central government or a non-government entity or a natural person.
PC	Political connection dummy. The value is 1 if one of a firm's directors, supervisors or top officers is or was: 1) a government official or 2) a representative of National People's Congress (NPC) or 3) a member of Chinese People's Political Consultative Conference (CPPCC); 0 otherwise.
NONPC	Non-political connection dummy. The value is 1 if a firm has no political connection; 0 otherwise.
LOCPC	Local political connection dummy. The value is 1 if a firm has local political connection; 0 if a firm has central political connection or no political connection.
SIZE	Firm scale, computed as the natural logarithm of total assets.
AGE	Duration from IPO to the sample year.
LEV	Leverage ratio, computed as total liabilities divided by total assets.
LIQ	Liquidity ratio, computed as current assets divided by current liabilities.
GO	Growth opportunity, measured as the sales revenue growth rate.
ROE	Return on equity, computed as net income divided by shareholders' equity.

Variables	Definition
PUNISH	Punishment exposure, measured as the number of punishments for corporate misdeeds, including illegal purchase of stock, fictitious profit, false equity, unauthorized use of funds, deferred disclosure, false statement, funding violation, material omissions, occupation of assets by large shareholders, share price manipulation, fraudulent listing, illegal guarantee and illegal speculation. The promulgators include China Securities Regulatory Commission (CSRC) and Stock Exchanges.
MTB	Market to book value, computed as the market value divided by the book value of total assets.
FCF	Enterprise free cash flow, computed as net profit + interest expenses + non-cash expenses - addition of working capital - capital expenditure.
INDDR	Independent directors, computed as the proportion of independent directors on board.
CON	Ownership concentration, computed as the Herfindahl Index (HHI) of the first ten shareholdings.

2.3.2.2 Independent variables

To measure government ownership, we created a dummy variable government ownership (GOV), which takes the value of 1 if the government directly and indirectly—through pyramid structures—holds most of the company shares, and 0 otherwise (Wang et al., 2008b; Xia and Fang, 2005).

To assess political connections, consistent with previous research (Chen et al., 2011a; Li et al., 2008; Wu and Liu, 2011; Wu et al., 2012b, 2012c), we created a dummy PC, which takes the value of 1 if a firm is identified as being politically connected, and 0 otherwise. Consistent with Faccio (2006), a company is defined as politically connected if at least one of its directors, supervisors, or top officers (CEO, president, vice-president, chairman, or secretary) is or was (1) a government official, or (2) a representative of the National People's Congress (NPC), or (3) a member of the Chinese People's Political Consultative Conference (CPPCC).[10] The connected directors, supervisors, and managers can be central or local officials or members of the Conference.

To measure the levels of political embeddedness, we differentiate companies with central, local, or no political embeddedness. Next, using the central level as the reference group, we created dummies for the local level and firms that are not politically embedded. The dummy LOCGOV takes a value of 1 if the de facto owner of a firm is a local government, and 0 otherwise. The dummy NONGOV takes a value of 1 if the de facto owner of a firm is not the government, and 0 if the government is the de facto owner. To create the dummies LOCPC and NONPC, we used a similar approach.

10 The NPC and CPPCC are the two most important political councils in China, collectively known as 'Lianghui'. According to the Chinese Constitution, the NPC is the national legislature and the highest authority in China; The CPPCC functions mainly in political consultation, democratic supervision and participation in politics.

Panels A–D in Table 2.1 present descriptive statistics of the distribution of government ownership and political connections for 2009–2013. Panel A shows the distribution of all observations across years and industries. Panel B shows the yearly distribution of de facto controllers' identity and political connections for 2009–2013. Government ownership remained stable, but the number of firms with political connections increased substantially. Panel C presents the distribution of government ownership and political connections across industrial sectors. The government, on central and local level, owns a high number of firms in key sectors, such as industry and public utilities, while the government controls fewer firms in non-strategic sectors, such as real estate and commercials. Panel D reports the distribution of government ownership and political connections across Chinese regions. In terms of proportion, government-owned firms are more numerous in the northern, northwestern, and central regions of China. In contrast with government ownership, political connections do not show considerable differences across industrial sectors or regions.

Table 2.3: Summary statistics

Variable	Obs	Mean	Median	Std.Dev.	Min	Max
RM_CFO (R)	5,531	0.005	0.031	0.672	-2.609	1.953
RM_PROD	5,531	0.009	0.157	0.925	-3.567	1.924
RM_DISX (R)	5,531	0.01	0.166	0.873	-3.994	1.816
RM_CD	5,531	2.302	2.312	0.059	1.902	2.471
RM_PD	5,531	2.3	2.320	0.089	1.828	2.474
RM_CPD	5,531	2.301	2.314	0.069	1.889	2.469
AM_MJ	5,531	0.385	0.213	0.496	0	2.713
AM_BS	5,531	0.484	0.286	0.586	0	3.047
AM	5,530	0.435	0.262	0.501	0	2.880
GOV	5,531	0.658	1	0.474	0	1
PC	5,531	0.621	1	0.485	0	1
SIZE	5,518	7.548	7.705	1.517	2.89	10.818
AGE	5,531	12.749	13.266	4.336	0.504	20.778
LEV	5,530	0.553	0.544	0.266	0.078	1.994
LIQ	5,476	1.604	1.267	1.351	0.124	9.07
GO	5,452	0.274	0.107	1.003	-0.779	7.767
ROE	5,531	0.066	0.073	0.206	-1.161	0.666
PUNISH	5,531	0.095	0	0.293	0	1
MTB	5,350	3.757	2.644	4.987	-10.695	36.016
FCF	5,530	-0.004	0.011	0.119	-0.565	0.269
INDDR	5,507	0.368	0.333	0.053	0.3	0.571
CON	5,530	0.171	0.132	0.133	0.001	0.8

Notes: The letter R in brackets indicates reversed scores. See Table 2.2 for variable definitions.

Table 2.4: Correlation matrix

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22
RM_CFO (R)	1																					
RM_PROD	0.54*	1																				
RM_DISX (R)	0.07*	0.64*	1																			
RM_CD	0.64*	0.81*	0.81*	1																		
RM_PD	0.33*	0.90*	0.90*	0.89*	1																	
RM_CPD	0.62*	0.94*	0.78*	0.96*	0.95*	1																
AM_MJ	0.07*	0.05*	-0.04*	0.00	0.00	0.02	1															
AM_BS	0.05*	0.02	-0.06*	-0.03	-0.03	-0.01	0.71*	1														
AM	-0.01	-0.00	-0.01	-0.02	-0.01	-0.01	0.07*	0.06*	1													
GOV	0.03	0.06*	0.04*	0.05*	0.05*	0.06*	-0.10*	-0.11*	-0.01	1												
PC	0.00	0.06*	0.06*	0.05*	0.06*	0.05*	-0.03	0.00	-0.02	0.04*	1											
SIZE	-0.07*	-0.10*	-0.09*	-0.11*	-0.10*	-0.11*	-0.27*	-0.24*	-0.06*	0.26*	0.15*	1										
AGE	0.04*	0.02	-0.01	0.01	0.00	0.01	0.11*	0.11*	0.04*	0.03	0.08*	-0.20*	1									
LEV	0.13*	0.20*	0.06*	0.12*	0.14*	0.16*	0.17*	0.16*	0.01	-0.02	0.02	-0.03	0.11*	1								
LIQ	-0.05*	-0.09*	-0.04*	-0.06*	-0.07*	-0.08*	-0.03	-0.02	-0.01	-0.12*	-0.02	-0.19*	-0.07*	-0.55*	1							
GO	-0.03	-0.02	0.00	-0.02	-0.02	-0.03	0.05*	0.06*	0.01	-0.06*	0.00	-0.08*	0.05*	0.04*	0.00	1						
ROE	-0.22*	-0.26*	-0.03	-0.15*	-0.16*	-0.21*	-0.14*	-0.16*	0.01	-0.01	0.00	0.10*	-0.06*	-0.13*	0.09*	0.15*	1					
PUNISH	-0.01	0.00	-0.02	-0.02	-0.01	-0.01	0.05*	0.04*	0.01	-0.09*	0.05*	-0.08*	0.08*	0.06*	-0.03	-0.01	-0.04*	1				
MTB	-0.04*	-0.08*	-0.05*	-0.07*	-0.07*	-0.08*	0.13*	0.11*	0.01	-0.10*	-0.06*	-0.23*	0.05*	-0.05*	0.01	0.09*	-0.20*	0.05*	1			
FCF	-0.04*	-0.05*	0.03	0.00	-0.01	-0.02	-0.10*	-0.12*	-0.00	0.04*	0.02	0.13*	-0.01	-0.04*	-0.14*	-0.08*	0.12*	-0.04*	-0.10*	1		
INDDR	-0.01	0.01	0.03	0.01	0.01	0.01	0.03	0.03	0.04*	-0.04*	-0.01	-0.03	-0.01	0.01	0.02	0.00	-0.02	0.00	0.01	-0.01	1	
CON	-0.10*	-0.03	0.07*	0.00	0.02	-0.01	-0.12*	-0.08*	-0.01	0.21*	0.05*	0.24*	-0.22*	-0.04*	0.02	0.07*	0.15*	-0.08*	-0.09*	0.06*	0.05*	1

Notes: The letter R in brackets indicates reversed scores. * Indicates statistical significance at 1% level. See Table 2.2 for variable definitions.

2.3.2.3 Control variables

Consistent with previous literature (Braam et al., 2015; Li and Zhou, 2005; Wang et al., 2008b; Wu et al., 2012b, 2012c), we included the following control variables: company scale (SIZE), duration since initial public offering (AGE), leverage ratio (LEV), liquidity of assets (LIQ), growth opportunity (GO), profit indicators (ROE), punishment exposure (PUNISH), market-to-book value (MTB), enterprise free cash flow (FCF), proportion of independent directors on the board (INDDR), and ownership concentration (CON). We also included year-dummies to control for omitted variables that vary over time but are constant among the firms, and industry-dummies to control for sector-specific effects. Table 2.3 reports summary statistics for the dependent, independent, and control variables employed in the analyses.

2.3.3 Method

Because we have repeated measurements at the firm level that are nested within provinces, we used multilevel (panel) data regression analyses to test the hypotheses. Multilevel analysis is an appropriate method to include explanatory variables at different levels simultaneously and to study interactions among these levels (Dong and Stettler, 2011). In this multilevel analysis, random effects at provincial level are controlled for differences between the provinces, such as corruption and economic development, whereas random effects at firm level are controlled for omitted variables that vary over time but are constant among the firms. To test the hypotheses, we used the following general multilevel regression model:

$$EM_{substitution} = \beta_0 + \beta_1 GOV + \beta_2 PC + \beta_3 FIRM_{CONTROL} + \beta_4 INDUSTRY_{CONTROL} + \beta_5 YEAR_{CONTROL} + \beta_6 PROVINCE_{CONTROL} + \varepsilon_{it}, \quad (6)$$

where the dependent variable $EM_{substitution}$ is a proxy for the substitution of real earnings management for accrual-based earnings management. The dependent, independent, and control variables of Equation (6) were described above and in Table 2.2.

Equation (6) tests whether substitution of real earnings management for accruals-based earning management generally takes place. However, to address the fact that it is difficult to infer the level at which the substitution takes place, as a robustness check, we also analyzed whether politically embedded firms (i) are more likely to use combinations of high levels of real earnings management strategies and low levels of accrual-based earnings management strategies and (ii) are less likely to use combinations of low levels of real earnings management strategies and high levels of accrual-based earnings management strategies than non-connected firms. Therefore, we defined another econometric specification, which estimates a firm's

likelihood for using diametrically opposing combinations of high and low levels of real and accrual-based earnings management strategies (as dependent variables):

$$\begin{aligned}\mathrm{RM}_{\mathrm{High/Low}}\&\mathrm{AM}_{\mathrm{Low/High}} &= \beta_0 + \beta_1 GOV + \beta_2 PC + \beta_3 FIRM_{CONTROL} + \beta_4 INDUSTRY_{CONTROL} \\ &+ \beta_5 YEAR_{CONTROL} + \beta_6 PROVINCE_{CONTROL} + \varepsilon_{it} \qquad (7)\end{aligned}$$

Equation (7) is identical to Equation (6) with the exception of the dependent variable(s). For estimation methods, we used multilevel logistic regressions for Equation (7).

In addition, the assumptions underlying the regressions were tested for multicollinearity based on Pearson correlations and the variance inflation factors. Table 2.4 reports the Pearson pair-wise correlations between all variables in the main tests. The correlations between the proxies for real earnings management and our comprehensive real earnings management proxies indicate that they overall are based on the same underlying construct. The variance inflation factors (VIFs) were smaller than 2 for each of the independent variables, which indicated that multicollinearity is not an issue. In addition, in an analysis of the residuals, normality and homoscedasticity were not rejected.

2.4 Results

Panel A in Table 2.5 reports the results of the regression analyses for the hypothesized relationships between political embeddedness and the substitution between different earnings management strategies in China.

Table 2.5: Effects of political embeddedness on earnings management substitution

Panel A: Effects of political embeddedness

	RM_CD/AM	RM_PD/AM	RM_CPD/AM
Model	(1)	(2)	(3)
GOV	0.469**	0.856***	0.668***
	(2.47)	(2.97)	(3.14)
PC	0.528***	1.019***	0.682***
	(2.80)	(3.55)	(3.22)
SIZE	-0.264***	-0.452***	-0.317***
	(-3.85)	(-4.33)	(-4.11)
LEV	2.457***	3.782***	3.157***
	(5.51)	(5.58)	(6.30)
LIQ	0.043	-0.006	0.053
	(0.53)	(-0.05)	(0.58)
GO	0.020	0.041	0.073
	(0.22)	(0.30)	(0.72)
ROE	-2.370***	-3.292***	-3.365***
	(-5.05)	(-4.61)	(-6.39)
AGE	-0.017	-0.040	-0.020
	(-0.79)	(-1.22)	(-0.82)
PUNISH	-0.075	-0.069	-0.067
	(-0.26)	(-0.16)	(-0.20)
MTB	-0.074***	-0.118***	-0.096***
	(-4.03)	(-4.25)	(-4.66)
FCF	-1.127	-1.902	-1.478*
	(-1.47)	(-1.63)	(-1.72)
INDDR	2.111	2.762	2.173
	(1.33)	(1.14)	(1.22)
CON	1.445**	2.696**	1.420*
	(2.08)	(2.56)	(1.83)
Industry dummies	Y	Y	Y
Year dummies	Y	Y	Y
Random province effects	Y	Y	Y
Random firm effects	Y	Y	Y
Intercept	-0.191	0.112	-0.331
	(-0.20)	(0.08)	(-0.32)
N	5251	5251	5251
Wald-chi2	139.652***	149.385***	186.168***

Notes: ***, ** and * indicate statistical significance at 1 %, 5 %, and 10 % levels respectively (two-tailed), z-values are below the regression coefficients in parentheses. Individual coefficients of the industry dummies, year dummies, and random province and firm effects are not reported for parsimony. See Table 2.2 for variable definitions.

Panel B: Effects of levels of political embeddedness

	RM_CD/AM	RM_PD/AM	RM_CPD/AM
	Model 1	Model 2	Model 3
LOCGOV	-0.683***	-1.196***	-0.927***
	(-3.03)	(-3.49)	(-3.66)
NONGOV	-0.961***	-1.726***	-1.336***
	(-3.91)	(-4.61)	(-4.83)
LOCPC	-0.141	-0.153	-0.084
	(-0.65)	(-0.47)	(-0.35)
NONPC	-0.604***	-1.103***	-0.736***
	(-2.83)	(-3.40)	(-3.08)
SIZE	-0.280***	-0.475***	-0.334***
	(-4.06)	(-4.52)	(-4.31)
LEV	2.422***	3.716***	3.105***
	(5.42)	(5.47)	(6.19)
LIQ	0.027	-0.032	0.032
	(0.33)	(-0.26)	(0.35)
GO	0.022	0.044	0.076
	(0.24)	(0.32)	(0.75)
ROE	-2.346***	-3.244***	-3.324***
	(-5.00)	(-4.54)	(-6.31)
AGE	-0.015	-0.038	-0.017
	(-0.70)	(-1.16)	(-0.70)
PUNISH	-0.062	-0.046	-0.046
	(-0.21)	(-0.10)	(-0.14)
MTB	-0.075***	-0.119***	-0.097***
	(-4.07)	(-4.27)	(-4.70)
FCF	-1.125	-1.896	-1.475*
	(-1.47)	(-1.63)	(-1.72)
INDDR	2.125	2.806	2.201
	(1.34)	(1.16)	(1.24)
CON	1.469**	2.772***	1.470*
	(2.11)	(2.62)	(1.88)
Industry dummies	Y	Y	Y
Year dummies	Y	Y	Y
Random province effects	Y	Y	Y
Random firm effects	Y	Y	Y
Intercept	1.468	3.064**	1.827*
	(1.49)	(2.04)	(1.65)
N	5251	5251	5251
Wald-chi2	150.401***	162.753***	200.923***

Notes: ***, ** and * indicate statistical significance at 1 %, 5 %, and 10 % levels respectively (two-tailed), z-values are below the regression coefficients in parentheses. Individual coefficients of the industry dummies, year dummies, and random province and firm effects are not reported for parsimony. See Table 2.2 for variable definitions.

The results for Models 1–3 in Panel A show positive and statistically significant associations between government ownership and the ratios of real and accrual-based earnings management strategies for all composite measurements, after controlling for other incentives for earnings management substitution. These results provide support for H1a, indicating that government-owned firms are more likely to substitute relatively costlier and less detectable real earnings management for accrual-based earnings management than non-government-owned firms. Moreover, these findings show that these results are qualitatively robust to the different measures of real earnings management.

Table 2.6 reports the results of the multilevel logistic regressions using the combinations of high and low, real and accrual-based earnings management strategies as dependent variables. The results for Model 1 shown in Table 2.6 show statistically significant positive coefficients for government ownership. These coefficients reflect the log of the odds ratio between government ownership and no government ownership, controlling for the other factors specified in the models. This odds ratio indicates the change in odds that government-owned firms use combinations of relatively high levels of real earnings management strategies and low levels of accrual-based earnings management strategies compared to non-government-owned firms, everything else held constant. The statistically significant association for Model 1 shown in Table 2.6 indicates that government-owned firms are more likely to use combinations of relatively high levels of real earnings management and low levels of accrual-based earnings management than non-government-owned firms. Moreover, Model 2 shows that government-owned firms are statistically significantly less likely to use combinations of relatively low real earnings management strategies and high accrual-based earnings management strategies, after controlling for other differences in earnings management incentives. Together, these results provide additional support for H1a.

Panel A in Table 2.5 also shows the results for the tests of H2a, which predicted that firms with political connections would be more likely to substitute real earnings management for accrual-based earnings management than firms without political connections. The statistically significant and positive results shown in Panel A support this notion. However, at the same time, the results in Table 2.6 also show a statistically significantly positive relationship between firms with political connections and the combination of AM_{high} and RM_{high}, and a statistically significantly negative association with AM_{low} and RM_{low}, indicating that politically connected firms use both earnings management strategies more than non-politically connected firms. Compared with non-politically connected firms, politically connected firms thus make a different trade-off between real and accrual-based management strategies. Specifically, compared with firms without political connections, politically connected firms are more likely to resort to less

detectable real earnings management strategies, but at the same time, these firms also use relatively more accrual-based earnings management. However, the relative increase in the use of real earnings management is greater than that of accrual-based earnings management. Collectively, the results thus indicate a relative substitution effect.[11]

Panel B in Table 2.5 shows the results for the tests of H1b and H2b, which collectively predicted that, in China, the substitution effect between real and accrual-based earnings management would be stronger for firms that are centrally politically embedded compared to firms that are locally politically embedded. The negative and statistically significant results for LOCGOV indicate that central government–owned firms are more likely to substitute real earnings management for accrual-based earnings management than local government–owned firms. These results provide support for H1b. However, the negative yet non-statistically significant results for LOCPC do not provide support for the expectation that the substitution effect will be stronger for firms with central political connections than for firms connected to local governments. Thus, the results do not support H2b.

11 To address the fact that the effect of the government ownership on firms' choices of earnings management strategies may differ depending on the existence of political connections and vice versa, we also estimated models including both the direct effects of government ownership and political connections and their interaction. The results of the additional tests (reported in Tables A.1 and A.2) did not show significant interaction effects, indicating no combined effects of government ownership and political connections on the substitution between different earnings management strategies for the Chinese listed firms. These findings suggest that the effects of the two dimensions of political embeddedness on earnings management substitution do not reinforce each other.

Table 2.6: Effects of political embeddedness on earnings management substitution dummies

	$AM_{LOW}RM_{HIGH}$	$AM_{LOW}RM_{HIGH}$	$AM_{LOW}RM_{HIGH}$	$AM_{LOW}RM_{HIGH}$
	Model 1	Model 2	Model 3	Model 4
GOV	0.203***	-0.222***	0.103	-0.010
	(2.61)	(-2.91)	(1.36)	(-0.13)
PC	0.033	-0.078	0.336***	-0.275***
	(0.43)	(-1.04)	(4.39)	(-3.66)
SIZE	-0.055**	0.131***	-0.284***	0.277***
	(-2.06)	(4.61)	(-10.40)	(9.29)
LEV	0.552***	-0.751***	0.642***	-1.757***
	(3.26)	(-3.67)	(3.78)	(-7.85)
LIQ	0.015	-0.066*	-0.003	-0.034
	(0.48)	(-1.95)	(-0.11)	(-1.02)
GO	-0.015	0.029	0.047	-0.154***
	(-0.39)	(0.86)	(1.32)	(-3.47)
ROE	-0.931***	2.059***	-1.909***	2.519***
	(-5.01)	(8.81)	(-10.01)	(9.01)
AGE	-0.010	0.017**	0.010	-0.008
	(-1.19)	(1.98)	(1.09)	(-0.92)
PUNISH	0.039	0.207*	-0.105	-0.151
	(0.33)	(1.83)	(-0.91)	(-1.21)
MTB	-0.059***	0.062***	-0.021***	0.014
	(-6.79)	(7.98)	(-2.88)	(1.37)
FCF	-0.590**	-0.518*	0.761**	0.289
	(-1.99)	(-1.68)	(2.52)	(0.88)
INDDR	2.164***	-0.495	-0.024	-2.128***
	(3.58)	(-0.77)	(-0.04)	(-3.24)
CON	0.973***	-0.441	-0.083	-0.696**
	(3.62)	(-1.58)	(-0.29)	(-2.48)
Industry dummies	Y	Y	Y	Y
Year dummies	Y	Y	Y	Y
Random province effects	Y	Y	Y	Y
Random firm effects	Y	Y	Y	Y
Intercept	-1.632***	-2.162***	0.489	-1.211***
	(-4.39)	(-5.67)	(1.30)	(-3.16)
N	5271	5271	5271	5271
Wald-chi2	176.007***	211.421***	308.894***	288.109***

Notes: In this table, the dependent variables are built with RM_CPD. Additional tests of this method with dependent variables built with RM_CD and RM_PD are demonstrated in Table A.3 and A.4 respectively. ***, ** and * indicate statistical significance at 1 %, 5 %, and 10 % levels respectively (two-tailed), z-values are below the regression coefficients in parentheses. Individual coefficients of the industry dummies, year dummies, and random province and firm effects are not reported for parsimony. See Table 2.2 for variable definitions.

2.5 Discussion and Conclusion

This study investigated how political embeddedness affects Chinese listed firms' choices for earnings management strategies. By using government ownership and political connections as measures of political embeddedness and multiple proxies for real and accrual-based earnings management, we show that government ownership and political connections play considerable but different roles in explaining the variance in the choices for earnings management strategies. The results indicate that government-owned firms, especially central government–owned firms, are more likely to substitute costly but less detectable real activities manipulation for accrual-based earnings management than non-government-owned firms. This finding is in line with the different cost-benefit structures of trading off real for accrual-based earnings management for government-owned and non-government-owned firms. Given the higher secrecy and potential to protect the firm's reputation, the marginal benefits of the use of real earnings management strategies obviously outweigh the marginal costs for government-owned firms, especially those owned by the central government.

The results also indicate that the trade-off between real and accrual-based management strategies differs between firms with and without political connections. Compared with firms without political connections, firms with political connections are more likely to resort to less detectable real earnings management strategies, but at the same time, firms with political connections also use more accrual-based earnings management. However, given that the relative increase in the use of real earnings management is greater than that of accrual-based earnings management, we speak of a relative substitution effect for politically connected firms. A potential explanation for this finding could be that, as indicated in previous literature (Li et al., 2008; Wu et al., 2012c), one of the most important criteria for the promotion of politically connected managers is corporate performance, which makes the multiple goals of politically connected managers (i.e., corporate, political and personal goals) interdependent. In this sense, corporate financial performance in the shorter term is more important for politically connected managers because it is closely related to their political careers (Li and Zhou, 2005). Thus, politically connected managers have strong incentives to pursue financial benefits to achieve political and personal objectives, such as promotion (Shleifer and Vishny, 1994). Although real earnings management is the first option for politically connected managers, accrual-based earnings management might also be adopted to achieve the expected level of corporate performance. In addition, political connections can be considered a protection mechanism that decreases the likelihood that outsiders will take disciplinary actions against the firm (Chaney et al., 2011; Li et al., 2008), which leaves room for politically connected managers to use relatively more accrual-based earnings management.

However, we do not find support for the hypothesis (H2b) that the substitution effect is stronger for firms with political connections to the central government than for locally connected firms. A potential explanation might be that due to fierce competition and institutional pressure, locally politically connected managers face more intense political, operational, and personal goal risks. The fast expansion of the Chinese economy is creating a competitive environment for listed firms, and innovation is needed more than ever. The marginal institutional benefits that politically connected firms get from the government could not cover the marginal costs of the lack of market competitiveness. Thus, corporate financial performance would be even more important when evaluating managers' operational success, which offers locally connected managers stronger incentives than ever to whitewash performances and use earnings management strategies. For this purpose, real earnings management is a better option because, as previously discussed, detection, which would jeopardize the managers' political career and personal goals, is costlier. Thus, locally connected managers could resort to real earnings management more and have a stronger relative substitution effect for accrual-based earnings management. Consequently, the substitution effect of locally connected firms becomes almost as strong as that of firms connected to the central government.

Collectively, the findings suggest that government ownership and political connections, as well as their different levels, play different incremental roles in explaining the variance in the earnings management strategy chosen. These results have several important implications for accounting practices and research related to earnings management. First, the results are likely to be helpful for external capital providers and other stakeholders in assessing the pervasiveness of earnings management and the overall integrity of the financial reporting of Chinese listed firms. Second, the finding that political embeddedness affects firms' choices of real and accrual-based earnings management strategies has important implications for research. In research settings where accrual-based and real earnings management strategies are likely to be used to achieve earnings targets, variation in earnings management cannot be fully captured by studying only accrual-based earnings management (Kim and Sohn, 2013). If firms trade off between different earnings management strategies, studying only the former could underestimate the earnings management activities of political embeddedness. Third, the results also imply that different types and levels of political embeddedness play considerable but different incremental roles in explaining the variance in the choices for earnings management strategies. In other words, the results suggest that central political embeddedness, especially government ownership, have stronger effects on the substitution between different earnings management strategies.

The results of this study have to be considered in relation to several limitations. Two limitations are related to the proxies of earnings management and political

embeddedness. Regarding the former, we considered only one aspect of earnings manipulation, the level of accrual-based and real earnings management. However, we did not examine the relationship between political embeddedness and other aspects of earnings management, such as timeliness, value relevance, and earnings conservatism (Dechow et al., 2010). Regarding our proxies of political embeddedness, we examine variation in earnings management strategies given the existence of government ownership and political connections. The underlying assumption in the empirical part is that all politically embedded firms are uniformly associated with choices for accrual-based and real earnings management strategies. However, the degree of political influence might differ among different firms. Moreover, the benefits from political connections should be expected to differ for a member of parliament or a minister in the government. Consequently, different types of political connections, in addition to the differentiation of local or central connections, may have different effects on firms' choices of earnings management strategies.

Further research is needed for a more detailed measurement of the degree of political influence on different firms. Further research could also compare and contrast the different effects of political embeddedness on earnings quality in the financial reports of public and private firms in China, and Chinese versus Western settings. Overall, more research is needed for an improved understanding of the influence of political embeddedness on financial reporting quality in different national and international contexts. This would help to identify critical factors that affect the choices of firms and their managers for different earnings management strategies.


CSR

Chapter 3

Political embeddedness and the diffusion of corporate social responsibility practices in China: A trade-off between financial and CSR performance?[12]

12 This chapter is based on a joint paper with Daniel Reimsbach and Geert Braam, *Political embeddedness and the diffusion of corporate social responsibility practices in China: A trade-off between financial and CSR performance?*. Current status: under review.

3.1 Introduction

Corporate social responsibility (CSR) is increasingly becoming a worldwide phenomenon. However, as Moon (2004) pointed out, "it remains contextual not only in terms of its corporate environment but also in terms of its national environment." Accordingly, the salience of CSR varies across countries and time periods (Steurer, 2010). Although CSR has been a well-established concept in developed economies for decades, it has more recently entered the business and political agenda in many emerging economies, such as China. As the world's largest emerging stock market, China has been playing an increasingly important role in the global economy (Chen et al., 2011b). As part of the Chinese government's political agenda, the government promotes CSR as a desired activity.[13] In a context like this, CSR is mainly a government-induced phenomenon. Steurer (2010) called for research on the effectiveness of government-induced CSR policies but also the opportunity costs that these policies imply. We answer this call by analyzing how Chinese listed firms make strategic CSR choices in response to government signals. Specifically, we investigate whether and how these signals may drive firms' initial decision to issue a CSR report, as well as the underlying CSR performance (CSRP) and a potential trade-off with corporate financial performance (CFP), representing opportunity costs.

However, government signals and pressures may not drive firms unitarily toward CSR; instead, firms may respond differently due to different types of dependency on the government (Post et al., 2002). A very important aspect of the Chinese stock market, which distinguishes it from its Western peers, is the pervasiveness of political embeddedness in many companies (Lee et al., 2014). Although many Chinese firms have been transformed from government entities into publicly traded companies, the government often remains the majority shareholder, maintaining ownership and control of these firms (Guthrie, 2012; Sun et al., 2002). Furthermore, extensive political connections between the government and/or the congress and a firm's senior management are still very common (Tu et al., 2013; Wu et al., 2012c). The strategic reactions of such politically embedded firms might differ from firms without political embeddedness because the embedded firms are subject to stronger government pressure and have to maintain their political legitimacy. Therefore, this study specifically addresses the relationship between government ownership and political connections and companies' strategic CSR choices.

Using panel data from 15,419 publicly traded firm-year observations in China for the years 2008–2014, the results show that politically embedded firms, and in particular firms that are centrally politically embedded, are more likely to issue CSR

13 In this paper, the term CSR is used in a broad sense, and includes real activities and investments that shape a firm's CSR performance, as well as the disclosure of this performance in designated corporate reports.

reports than firms without political embeddedness. The results also indicate that politically embedded firms, on average, have a higher CSRP than non-politically embedded firms. Finally, the results show that CSRP is more negatively related to CFP for politically embedded firms than for firms without political embeddedness. This result indicates that political embeddedness also affects the trade-off between corporate financial performance and CSR performance.

This paper contributes to the ongoing research related to political embeddedness and CSR in several ways. First, we complement the non-financial reporting literature that often focuses on the business and societal drivers of corporate social responsibility (Liu and Anbumozhi, 2009; Moon, 2004; Shi et al., 2008; Zhang et al., 2008) by focusing on the role of governments as drivers of the diffusion of firms' CSR-related practices. This research provides the first evidence of both the effectiveness of government-induced CSR policies in China and the potential opportunity costs that the policies imply: the tradeoff with financial performance. Second, we contribute to the literature on the effects of political network connections. Recent studies about the effects of political embeddedness on corporate policies or strategies have focused on either government ownership (Chen et al., 2008; Xu and Wang, 1999) or political connections (Tu et el., 2013; Wu et al., 2012c). However, a singular focus on either government ownership or political connections underestimates the total effects of political embeddedness. Our study complements this network literature by applying a more comprehensive measure of political embeddedness, using government ownership and political connections as proxies for firms' total political embeddedness. In addition, we consider in more depth different levels of political embeddedness. We differentiate between the central and local government levels in firm ownership and senior managers' political connections which allows us to present a more fine-tuned picture of the mechanisms behind the effects of political embeddedness. Third, we also contribute to the organizational theory literature by analyzing how firms strategically react to government signals. Most importantly, we add to the work of Marquis and Qian (2014), who show that government signaling is an important mechanism of political influence (also see Geng et al., 2010) and that different types of dependency on the government expose firms to different types of legitimacy pressure. In this paper, we analyze the potential opportunity costs that adhering to government signals regarding CSR imply. Thus, we shift the focus from a pure analysis of the effectiveness of government CSR initiatives to an efficiency-oriented perspective, which also takes into account how political embeddedness influences the relationship between CFP and CSRP.

The remainder of this paper is structured as follows. First, we present a review of related literature and develop hypotheses. Next, we describe our research method and then present the results of our analyses. Finally, we provide conclusions and discuss limitations, as well as potential directions for future research.

3.2 Background and hypotheses

Politically embedded firms are firms that have strong government ties, either via state ownership or via network connections (Marquis and Qian, 2014). On one hand, politically embedded firms may have better access to government resources, but on the other, these firms are probably highly monitored and thus, are more likely to adhere to government signals.

China is a very good example of an institutional setting with politically embedded firms (Lau et al., 2016; Marquis and Qian, 2014). Although the country has moved significantly toward a more market-oriented system over the last few decades, China's economy is still characterized by strong government control (Lee et al., 2014; Xu and Zeng, 2016). Although many Chinese firms have been transformed from government entities into publicly traded companies, often the government is still the majority shareholder and thus maintains ownership and de facto control of these firms, i.e., the ability to direct a company to act on the government's behalf (Guthrie, 2012; Sun et al., 2002). Furthermore, extensive political connections between the government and firms' senior management are still very common (Tu et al., 2013; Wu et al., 2012c). There are many examples of companies in which corporate executives are also local or central government officials (Ma and Parish, 2006; Marquis and Qian, 2014). There is also ample support for the supposed resource advantage of politically embedded firms in China. Due to the natural bond with the government, politically embedded firms are, for example, found to gain more financial support from the government via easier access to debt financing and lower taxation (Claessens et al., 2008; Faccio, 2010; Goldman et al., 2013; Johnson and Mitton, 2003; Khwaja and Mian, 2005), to have preferential access to government contracts (Goldman et al., 2009), or to obtain benefits from regulatory protection (Kroszner and Stratmann, 1998). Overall, China is a very well-suited empirical setting to analyze the effects of government signals on politically embedded firms' strategic choices.

A very topical example of such a government signal is the promotion of CSR and sustainable business conduct. Although the discussion about CSR has a long history in Western countries, it is more recent in emerging economies, such as China. While the first years after the economic reform were geared toward growth "at all costs" (Marquis and Qian, 2014, p.129), today a shift in China's economic development can be observed which also acknowledges the need to address the social and environmental effects of business activities (See, 2009). Accordingly, there is ample proof that the Chinese government signals that CSR is a desired activity (Geng et al., 2010; Marquis et al., 2011; Marquis and Qian, 2014; See, 2009). This is, for example, documented by Communist Party Committee statements that promote "social responsibility amongst citizens, enterprises and all kinds of organizations"

(Sino-Swedish CSR Cooperation, 2009). As a consequence, state-controlled institutions, such as the Shanghai and Shenzhen stock exchanges, issued guidelines and recommendations for CSR reporting (Lin, 2010), and the Chinese government developed its own specific reporting standard for Chinese companies (Geng et al., 2010; Marquis and Qian, 2014). Overall, in China the government can be considered an important driver of CSR (Liu and Anbumozhi, 2009; Xu and Zeng, 2016; Zhang et al., 2008).

Against this background, the question arises whether a firm's political embeddedness affects the firm's CSR practices, most importantly, the initial decision to issue a CSR report, but also the firm's CSRP, as well as the relation between CFP and CSRP. Determinants of CSR reporting seemed to be one of the first areas of interest in the related scholarly research. Consequentially, a plethora of studies have analyzed the likelihood of engaging in CSR reporting (for an overview, see Braam et al., 2016; Hahn and Kühnen, 2013; Liu and Anbumozhi, 2009). One of the prominent anchors in this discussion is legitimacy theory. The premise of legitimacy theory is that companies do not have an inherent right to exist; instead, society grants them a "license to operate" (Deegan, 2002). Thus, companies need to have legitimacy to access the necessary resources to successfully conduct business. A specific aspect among different levels of legitimacy is political legitimacy, which Marquis and Qian (2014, p.127) define as "the extent to which the government views the firm's actions as being in accordance with norms and laws." In a context where the government signals that CSR (reporting) is a desired activity, political legitimacy can be achieved by adhering to this signal and publishing a CSR report.

Marquis and Qian (2014) argue that politically embedded firms have political legitimacy per se and thus, have less incentive to adhere to the government signal and publish a CSR report than non-politically embedded firms. However, this argument contradicts a control-oriented perspective, which suggests that regulatory pressure from the government can significantly shape politically embedded firms' behavior toward CSR (Huang and Kung, 2010; Zhao, 2012). This argument is particularly true in China where politically embedded firms are often used as pioneers in adhering to the government's signals and implementing the encouraged policy (Zeng et al., 2012). The control-oriented perspective applies to both dimensions of political embeddedness. The government can directly shape firms' CSR practices via (majority) ownership. Consistently, Amran and Haniffa (2011), Gallo and Jones Christensen (2011), and Tagesson et al. (2009) find initial empirical evidence for a positive relation between government ownership and CSR disclosure in different institutional and regional settings. In addition, the government can indirectly shape firms' CSR practices via politically connected executives. By taking actions in accordance with government policies, such as issuing CSR reports, politically connected executives maintain their legitimacy in the eyes of the government (Marquis and Qian, 2014)

and thus, also ensure their future political careers (Patten and Trompeter, 2003). Agency theory explains these actions by suggesting that executives may act in their own best interests, and in cases of conflicting interests, also at the expense of the firm's owners and other stakeholders (Jensen and Meckling, 1976). Given the theoretical background outlined above, the peculiarities of the Chinese setting, and the empirical evidence from other settings, we differ from Marquis and Qian's (2014) approach and focus on the control- and agency-oriented perspectives expecting that politically embedded firms are more likely to issue a CSR report than firms without political embeddedness:

Hypothesis 1: Politically embedded firms are more likely to issue a CSR report than firms without political embeddedness.

Political embeddedness, however, is likely to influence not only the decision to issue a CSR report but also the decision to invest in CSR activities that shape the CSRP a firm can present in its report. In the current Chinese setting, in line with the Chinese ideology of building a harmonious society (See, 2009), the government has strong incentives to divert wealth to obtain societal welfare (Bai et al., 2006; Shi et al., 2008) via, for example, infrastructure development and resolution of the region's fiscal and unemployment challenges (Li and Zhang, 2010), and to overcome environmental problems, for instance, caused by climate change and pollution (Xu and Zeng, 2016; Zeng et al., 2012). Accordingly, it is in the government's interest that firms pursue non-financial objectives related to the official government policy (Wei and Varela, 2003; Xia and Fang, 2005). Therefore, it can be expected that the Chinese government exerts pressure on firms to pursue CSR activities and invest in CSR (Cho and Patten, 2007; Darrell and Schwartz, 1997; Patten and Trompeter, 2003; See, 2009). Government-owned firms play a key role in this context, as they are often used as role models and pioneers in implementing government policies. Government-owned firms, therefore, receive even stronger pressure to invest in CSR activities, especially in a context where they are also urged to publicly report on their CSR achievements (Xu and Zeng, 2016). In addition, previous research has shown that slack resources can significantly affect firms' CSR activities (Marquis and Qian, 2014; Seifert et al., 2004; Waddock and Graves, 1997; Wang et al., 2008a). In China, government-owned firms usually get more access to financial resources, such as bank loans (Khwaja and Mian, 2005; Li et al., 2008), government subsidies (Chen et al., 2011b), and favorable regulatory treatment (Agrawal and Knoeber, 2001). This access equips the firms with more slack resources and enables them to invest more in CSR activities. Overall, and in line with previous research that has shown government-owned enterprises, for example, invest more in environmental protection than private firms (Chang et al., 2015; Zeng et al., 2012), we expect that

government-owned firms invest more in CSR activities, resulting in a higher CSRP compared to firms without government ownership.

Similarly, it can be assumed that, in a setting where CSR is considered a desired activity by the government, firms with political connections tend to invest more in CSR activities due to the personal goals of politically connected senior managers. As mentioned earlier, compared with their counterparts without political connections, executives with political connections have stronger incentives to protect their reputation and to maintain their personal political legitimacy (Marquis and Qian, 2014). In doing so, they ensure their political career. These assumptions are also in line with Xu and Zeng (2016) who find that managers with a reputation for conducting high CSR investment increase their chances of promotion (also see Cao and Dou, 2007) and obtain other political benefits.

Overall, both government ownership and political connections can be assumed to increase firms' willingness to invest in CSR activities thus also increasing their CSRP. Therefore, we expect:

Hypothesis 2: The CSRP of politically embedded firms is higher than the CSRP of firms without political embeddedness.

Apart from the hypothesized influence of political embeddedness per se, different levels of political embeddedness are also likely to have different effects on firms' CSR practices. In general, firms that are politically embedded at the central level have a closer bond with the central government and play more crucial roles in a country's economic and political system (Chen et al., 2004; Sun et al., 2002). For these reasons, the implementation of government policy in China is a gradual process starting at the central level and then down to the local level. The encouragement from the Chinese government for firms to voluntarily issue CSR reports and increase their CSRP would first be delivered to firms that are politically embedded at the central level. Accordingly, the Chinese central government released "Guidelines to the State-owned Enterprises Directly under the Central Government on Fulfilling Corporate Social Responsibilities" in 2008. These guidelines are specifically designed to encourage firms owned by the central government to fulfill their social responsibilities (Zheng et al., 2014).

Furthermore, as Marquis and Qian (2014) argue, a firm's strategic response to government signals may vary with the likelihood or extent of government monitoring. In China, the regulatory environment for centrally politically embedded firms differs from that for local firms (Wang et al., 2008b). Firms that are politically embedded at the central level are usually subject to stricter monitoring by the central government and regulatory institutions, such as the State-owned Asset Supervision and Administration Commission (SASAC) and the China Securities Regulatory

Commission (CSRC), because of the firms' crucial role in the Chinese economy (Chen et al., 2004; Sun et al., 2002). If these firms fail to fulfill their social responsibilities, the negative reputational consequences are likely to also be attributed to the central government and thus, the country as a whole. Given this increased government monitoring and factoring in that politically embedded firms at the central level probably have even more slack resources than their local counterparts, we expect that the level of embeddedness plays a role in explaining the likelihood of issuing a CSR report and firms' CSRP:

Hypothesis 3a: Political embeddedness at the central level has stronger effects on a firm's likelihood of issuing a CSR report than political embeddedness at the local level.

Hypothesis 3b: Political embeddedness at the central level has stronger effects on a firm's CSRP than political embeddedness at the local level.

Until now, we have argued that political embeddedness positively affects firms' likelihood of issuing a CSR report and their CSRP. This would imply that political embeddedness is a factor that increases the effectiveness of implementing government policies. This perspective, however, neglects potential opportunity costs. Given that issuing a CSR report and investing in CSR activities are very costly, a potential trade-off between CSRP and CFP needs to be addressed as well.

Previous research on the CFP–CSRP relationship is controversial (Tang et al., 2012; Zeng et al., 2010) and offers mixed and inconclusive empirical findings (e.g., Barnett and Salomon, 2006; Luo et al., 2015; Margolis and Walsh, 2003). Some scholars argue for a positive relation based on the argument that a better CSRP helps firms to create a positive image from a stakeholder perspective (Fry et al. 1982, Haley, 1991; Nollet et al., 2016; Xiong et al., 2016) and thus, secures access to critical resources (Fombrun et al., 2000; Frooman, 1999). In contrast, other studies find a negative or no significant relation between CSRP and CFP. Here, the main arguments brought forward are that the involvement in CSR activities diverts corporate resources and undermines CFP (Friedman, 2007) and that firms conduct CSR activities primarily driven by managers' personal network needs (Marquis et al., 2007).

It is commonly agreed that the CSRP–CFP relationship is context-specific (e.g., Tang et al., 2012; Xiong et al., 2016) and may vary across jurisdictions, which helps explain the inconclusive empirical findings. In the Chinese context, where government influence pervasively exists in corporate businesses, political embeddedness could play an important role in affecting the CSRP–CFP relationship. Government-owned firms perform CSR activities and increase their CSRP due to political pressure. Such government intervention often comes with low efficiency

and reallocation of resources away from their (financially) optimal use. In this case, the increased CSRP of government-owned firms would be interpreted by market participants as a result of the government's bureaucratic intervention in regular corporate business, thus, decreasing the market-based CFP. In contrast, the CSRP of non-government-owned firms would be perceived more as a reflection of market-driven motives. Consequently, the better CSRP of government-owned firms could lead to a stronger trade-off with CFP compared to non-government-owned firms.

Investment in CSR activities could have more costs for politically connected firms as well. As outlined above, agency theory suggests that executives may act in their own best interests, but at the expense of the firm's owners and other stakeholders (Jensen and Meckling, 1976). In the case of CSR, the potential for a conflict of goals between executives and stakeholders is likely to be very salient (Wang et al., 2008b). As shown in previous literature, politically connected managers are more likely to be involved in self-interested activities to enhance their own political capital and personal career (Tu et al., 2013; Wu et al., 2012b, 2012c). Thus, it is reasonable for investors to suspect that politically connected managers invest in CSR to build personal reputations within social and political circles or to pursue their political career agendas at the expense of the shareholders. Furthermore, active involvement in CSR may also send a signal to the market that a firm has a large pool of slack resources (Preston and O'Bannon 1997; Seifert et al. 2004; Wang et al., 2008a). In such cases, politically connected firms are more likely to be suspected by investors of conducting possible self-serving managerial behavior, resulting in a lower market price. This, in turn, suggests that the better CSRP of politically connected firms is associated with a lower CFP than that of firms without political connections. Based on the arguments above, we hypothesize the following:

Hypothesis 4: For politically embedded firms, CSRP is more negatively related to CFP than for non-politically embedded firms.

3.3 Research method

3.3.1 Sample selection and descriptive statistics

To test the hypotheses, we used data from Chinese public listed companies of the Shanghai and Shenzhen stock exchanges for the years 2008–2014. Consistent with previous studies (Chen et al., 2011b; Wu et al., 2012b; Xia and Fang, 2005; Zeng et al., 2012), we excluded listed firms of B shares or H shares because these firms are regulated by overseas or Hong Kong laws and regulations, which makes the nature of the firm's financial and non-financial disclosures not comparable to those of A-share listed companies. Data on financial and non-financial information,

including CSR report issuance, was extracted from the China Stock Market and Accounting Research (CSMAR) database, firms' annual reports, the RKS (Runling) CSR rating agency, and the Bloomberg Database. CSMAR is the primary source for financial and non-financial data of Chinese listed firms, including their financial statements. The data on CSRP was retrieved from the RKS (also see, Marquis and Qian, 2014), whose organization and China-specific products are modeled after the US social investment rating agency Kinder, Lydenberg, Domini and Co., Inc. (KLD). The RKS provides ratings on CSRP based on firms' activities as presented in their CSR reports. Bloomberg provides environmental, social, and corporate governance scores (ESG scores), which also serve as proxies for companies' CSRP (Aragón-Correa, Marcus, and Hurtado-Torres, 2016; Shrivastava and Addas, 2014).[14] Our analysis was restricted to firms for which all financial and non-financial information was available. After these data were merged and observations that were missing were removed, the remaining unbalanced panel dataset included 15,419 firm-year observations, including 3,447 firm-year observations of companies that issued a CSR report.

Table 3.1 presents the descriptive statistics for the sample companies. Panel A shows the yearly distribution of the sample firms across industries. Panel B presents the yearly distribution of the sample firms that are government-owned, have political connections, and issue CSR reports. Panel B indicates that, overall, the proportion of both government-owned and politically connected firms remained stable, while the number of firms that issued CSR reports increased over time. Panel C depicts the distribution of the sample firms that are government-owned, have political connections, and issue CSR reports across industries. Panel C shows that the government holds the most shares in key industries such as real estate and public utility, whereas the financial sector has the highest percentage of politically connected firms and firms that issued CSR reports.

14 The Bloomberg ESG data was collected from different disclosure sources, such as CSR reports, annual reports, company websites, as well as a Bloomberg survey. The ESG scores are based on companies' ESG performance in environmental, social, and governance-related CSR performance aspects (Eccles et al., 2011; Nollet et al., 2016).

Table 3.1: Descriptive statistics for sample firms (2008-2014)

Panel A: Distribution of observations in terms of industries and years

	2008	2009	2010	2011	2012	2013	2014	Total
Finance	34	36	41	44	45	45	46	291
Manufacturing	1,037	1,142	1,417	1,601	1,698	1,729	1,821	10,445
Real estate	162	168	171	177	180	180	181	1,219
Commercials	136	139	149	154	157	157	160	1,052
Comprehensive	55	58	73	75	78	80	80	499
Public Utility	179	209	256	290	312	324	343	1,913
Total	1,603	1,752	2,107	2,341	2,470	2,515	2,631	15,419

Panel B: Yearly distribution of government ownership, political connections and the likelihood of issuing a CSR report

		2008	2009	2010	2011	2012	2013	2014	Total
GOV	N	855	747	811	832	957	937	942	6,081
	%	53.34%	42.64%	38.49%	35.54%	38.74%	37.26%	35.80%	39.44%
Non-GOV	N	748	1,005	1,296	1,509	1,513	1,578	1,689	9,338
	%	46.66%	57.36%	61.51%	64.46%	61.26%	62.74%	64.20%	60.56%
	Total	1,603	1,752	2,107	2,341	2,470	2,515	2,631	15,419
PC	N	784	855	1,024	1,125	1,170	1,171	1,201	7,330
	%	48.91%	48.80%	48.60%	48.06%	47.37%	46.56%	45.65%	47.54%
Non-PC	N	819	897	1,083	1,216	1,300	1,344	1,430	8,089
	%	51.09%	51.20%	51.40%	51.94%	52.63%	53.44%	54.35%	52.46%
	Total	1,603	1,752	2,107	2,341	2,470	2,515	2,631	15,419
Issue	N	178	185	497	587	612	678	710	3,447
	%	11.10%	10.56%	23.59%	25.07%	24.78%	26.96%	26.99%	22.36%
Not Issue	N	1,425	1,567	1,610	1,754	1,858	1,837	1,921	11,972
	%	88.90%	89.44%	76.41%	74.93%	75.22%	73.04%	73.01%	77.64%
	Total	1,603	1,752	2,107	2,341	2,470	2,515	2,631	15,419

Panel C: Distribution of government ownership, political connections and the likelihood of issuing a CSR report across industry

		Finance	Manufac-turing	Real estate	Commer-cials	Compre-hensive	Public Utility	Total
GOV	N	118	3,831	615	519	164	834	6,081
	%	40.55%	36.68%	50.45%	49.33%	32.87%	43.60%	39.44%
Non-GOV	N	173	6,614	604	533	335	1,079	9,338
	%	59.45%	63.32%	49.55%	50.67%	67.13%	56.40%	60.56%
	Total	291	10,445	1,219	1,052	499	1,913	15,419
PC	N	240	4,909	558	528	243	852	7,330
	%	82.47%	47.00%	45.78%	50.19%	48.70%	44.54%	47.54%
Non-PC	N	51	5,536	661	524	256	1,061	8,089
	%	17.53%	53.00%	54.22%	49.81%	51.30%	55.46%	52.46%
	Total	291	10,445	1219	1,052	499	1,913	15,419
Issue	N	219	2,225	304	171	96	432	3,447
	%	75.26%	21.30%	24.94%	16.25%	19.24%	22.58%	22.36%
Not Issue	N	72	8,220	915	881	403	1,481	11,972
	%	24.74%	78.70%	75.06%	83.75%	80.76%	77.42%	77.64%
	Total	291	10,445	1,219	1,052	499	1,913	15,419

3.3.2 Variables

3.3.2.1 Dependent variables

To test the hypotheses, we used three dependent variables. First, we created a dummy variable CSR, which takes the value 1 if a company issued a sustainability report, and the value 0 otherwise. Second, and consistent with recent studies (Lau et al., 2016; McGuinness et al., 2017), we used the RKS rating scores as a composite measure of CSRP, similar to studies that use the KLD score as an indicator of CSRP for US firms (Luo et al., 2015; Turban and Greening, 1997; Waddock and Graves, 1997). For robustness, we also used the ESG disclosure score from the Bloomberg database, which assesses the ratings of Bloomberg's analysts on the degree of transparency of a company's reporting on ESG performance (Lai et al., 2016; Nollet et al., 2016; Utz and Wimmer, 2014). Finally, we used composite measures to assess the trade-off between CSRP and CFP. For this purpose, we computed two dummy variables that assess a firm's CSRP in combination with its CFP. The dummy variable $CSRP_{High}CFP_{Low}$ is a dummy coded 1 (zero otherwise) if the CSRP of firm i in year t is above the industry-year median[15] and the CFP is below the industry-year median, thus representing firms that have a high CSRP ($CSRP_{High}$) combined with a low financial performance (CFP_{Low}). Similarly, $CSRP_{Low}CFP_{High}$ is a dummy that represents firms with a high CFP and a low CSRP (coded as 1, and 0 otherwise). To measure a company's CSRP, we used the RKS and ESG scores, and we used two indicators to assess CFP that combine market- and accounting perspectives, i.e., Tobin's Q (Gunasekarage et al., 2007; Hess et al., 2010; Ng et al., 2009; Tian and Estrin, 2008; Wei and Varela, 2003) and the price-to-book value ratio (Gunasekarage et al., 2007; Sun and Tong, 2003; Sun et al., 2002; Xu and Wang, 1999).

15 A practical justification for the use of this cut-off point is that it splits the sample into two groups of equal size. This grouping eliminates potential small sample and selection biases that may occur when, for example, the average is used as a cut-off point. To test the robustness of the results, we also used alternative cut-off points to check whether the cut-off at the median may have driven our results; that is, we repeated the analyses using the top 25% and 10% of the sample. The results of the additional tests show that the results do not change qualitatively, suggesting that the results are robust to different cut-off levels.

Table 3.2: Variable definitions

Variables	Definition
CSR	CSR is a dummy variable that is equal to 1 if a firm issues a CSR report, and 0 otherwise.
CSRP	CSRP is measured by the RKS rating score and, for robustness, by the Bloomberg ESG disclosure score.
RKS	RKS (Runling) rating score as composite measure of CSRP (Lau et al., 2016; Marquis and Qian, 2014; McGuinness et al., 2017).
ESG	Bloomberg disclosure score on ESG performance as second indicator of CSRP (Lai et al., 2016; Nollet et al., 2016; Utz and Wimmer, 2014).
TQ	Tobin's Q is computed as the market value of equity and debts divided by total assets (Gunasekarage et al., 2007; Hess et al., 2010; Ng et al., 2009; Tian and Estrin, 2008; Wei and Varela, 2003).
PB	The price to book value ratio is computed as the market value of equity divided by the book value of equity (Gunasekarage et al., 2007; Sun and Tong, 2003; Sun et al., 2002; Xu and Wang, 1999).
$CSRP_{High}CFP_{Low}$	CSRP and CFP combination dummy. The value is 1 if CSRP is higher than the industrial median and CFP is lower than the industrial median, and 0 otherwise. CSRP is proxied by either the RKS or ESG score, and CFP is proxied by either TQ or the PB ratio.
$CSRP_{Low}CFP_{High}$	CSRP and CFP combination dummy. The value is 1 if CSRP is lower than the industrial median and CFP is higher than the industrial median, and 0 otherwise. CSRP is proxied by either RKS or ESG score, and CFP is proxied by either TQ or the PB ratio.
GOV	Government ownership is a dummy variable that is equal to 1 if the de facto owner of a firm is the government, and 0 otherwise. The government has de facto ownership if it directly and indirectly holds the most shares (Wang et al., 2008b; Xia and Fang, 2005).
GOVLEVEL	Government ownership level is a dummy variable that is equal to 1 if the de facto owner of a firm is the central government, and 0 otherwise.
NONGOV	Non-government ownership is a dummy variable that is equal to 1 if the de facto owner of a firm is not the government, and 0 otherwise.
LOCGOV	Local government ownership is a dummy variable that is equal to 1 if the de facto owner of a firm is local government, and 0 otherwise.
PC	Political connection is a dummy variable that is equal to 1 if one if a firm's directors, supervisors or senior managers are or were 1) a government official, 2) a representative of National People's Congress (NPC), or 3) a member of the Chinese People's Political Consultative Conference (CPPCC), and 0 otherwise (Wang et al., 2008b; Wu et al., 2012b, 2012c).
PCLEVEL	Political connection level is a dummy variable that is equal to 1 if a firm has central political connections, and 0 otherwise.
NONPC	Non-political connection is a dummy variable that is equal to 1 if a firm has no political connections, and 0 otherwise.
LOCPC	Local political connection is a dummy variable that is equal to 1 if a firm has local political connections, and 0 otherwise.
SIZE	Company size is a relative measure that assesses the total assets per employee (Wang et al., 2008a; Zhao, 2012).
AGE	Company age is proxied by the duration from the initial public offering (IPO) to the sample year (Clarkson et al., 2008; Marquis and Qian, 2014; Wang et al., 2008a; Zeng et al., 2012).
ROA	Return on assets is computed as net income divided by the average total assets (Wang et al., 2008a; Xu and Zeng, 2016).
LEV	Leverage is measured as the total liabilities divided by the total assets (Wang et al., 2008a; Li and Zhang, 2010; Xu and Zeng, 2016).

Variables	Definition
GROWTH	Growth is measured as the sales revenue growth rate (Chang et al., 2015).
FCF	Company's free cash flow is computed as the sum of the net profit, interest expenses, and non-cash expenses minus the sum of the addition of working capital and capital expenditure (Marquis and Qian, 2014; Wang et al., 2008a; Zhao, 2012).
INDEPENDENCE	The proportion of independent directors is computed as the number of independent directors divided by the total number of directors on board (McGuinness et al., 2017).
VISIBILITY	Visibility controls for negative media exposure and public visibility and is measured as the number of punishments promulgated by the CSRC for corporate misdeeds, including illegal purchase of stock, fictitious profit, false equity, unauthorized use of funds, deferred disclosure, false statement, funding violation, material omissions, occupation of assets by large shareholders, share price manipulation, fraudulent listing, illegal guarantee, and illegal speculation (Al-Tuwaijri et al., 2004; Hughes et al., 2001; Huang and Kung, 2010).
CROSSLISTING	Cross-listing is a dummy that is equal to 1 if a firm is listed domestically and internationally, and 0 otherwise (McGuinness et al., 2017; Zeng et al., 2012).
INDUSTRY	Industry dummies control for sector-specific effects.
PROVINCE	Province dummies control for regional effects.
YEAR	Year dummies control for time effects and for omitted variables that vary over time, but are constant among firms.

3.3.2.2 Independent variables

To measure government ownership, we created a dummy variable (GOV), which takes the value 1 if the government directly and indirectly—through pyramid structures—holds the majority of the company shares, and 0 otherwise (Wang et al., 2008b; Xia and Fang, 2005).

To assess political connections, and consistent with previous research (Chen et al., 2011a; Li et al., 2008; Tu et al., 2013; Wu and Liu, 2011; Wu et al., 2012b, 2012c), we created a dummy (PC), which takes the value 1 if a firm is identified as being politically connected, and 0 otherwise. A company is defined as politically connected if at least one of its directors, supervisors, or senior officers (CEO, president, vice-president, chairman, or secretary) is or was (1) a government official, and/or (2) a representative of the National People's Congress (NPC), and/or (3) a member of the Chinese People's Political Consultative Conference (CPPCC) [16] (also see, Wang et al., 2008b; Wu et al., 2012b, 2012c).

To measure different levels of political embeddedness, we differentiated between companies with central, local, or no political embeddedness. Using the central level as the reference group, we created dummies for the local level and firms that are not politically embedded. The dummy LOCGOV takes the value 1 if the de facto owner of a firm is a local government and 0 otherwise. The dummy NONGOV takes the value 1 if the de facto owner of a firm is not the government, and 0 otherwise.

16 The NPC and CPPCC are the two most important political councils in China, collectively known as 'Lianghui'. According to the Chinese Constitution, the NPC is the national legislature and the highest authority in China; The CPPCC functions mainly in political consultation, democratic supervision and participation in politics.

To create the dummies for political connections, we used a similar approach with political connections at the central level as the reference group. The dummy variables LOCPC and NONPC are coded 1 if a company has political connections at the local level and no political connections, respectively, and 0 otherwise.

3.3.2.3 Control variables

Consistent with previous literature, we included the following firm-specific control variables: company size (SIZE) (Wang et al., 2008a; Zhao, 2012), company age (AGE) (Clarkson et al., 2008; Marquis and Qian, 2014; Wang et al., 2008a; Zeng et al., 2012), return on assets (ROA) (Wang et al., 2008a; Xu and Zeng, 2016), leverage (LEV) (Li and Zhang, 2010; Wang et al., 2008a; Xu and Zeng, 2016), company's growth (GO) (Chang et al., 2015), company's free cash flows (FCF) (Marquis and Qian, 2014; Wang et al., 2008a; Zhao, 2012), and the percentage of independent directors on the board (INDEPENDENCE) (McGuinness et al., 2017). To control for negative media exposure and public visibility (Al-Tuwaijri et al., 2004; Marquis and Qian, 2014), we added the variable visibility (VISIBILITY), which was measured as the number of punishments promulgated by the CSRC for corporate misdeeds (Huang and Kung, 2010; Hughes et al., 2001). To control for the extent to which international pressures drive a firm's CSR-related practices, we accounted for whether a company was cross-listed at an international stock exchange (CROSSLISTING) (McGuinness et al., 2017; Zeng et al., 2012). Finally, we added industry dummies (INDUSTRY) and province dummies (PROVINCE) to control for sector-specific and regional effects, respectively, and we included year dummies (YEAR) to control for the omitted variables that vary over time but are constant among the firms.

To deal with the problem of extreme outliers in the continuous control variables, we winsorized all continuous variables at the 1% and 99% percentiles of their distribution. Table 3.2 summarizes the definitions of the dependent, independent, and control variables employed in the analyses. Table 3.3 reports the summary statistics for these variables.

3.3.3 Research model

We used multilevel logistic and linear panel data regression analyses to test the hypotheses. For this reason, we estimated the following multilevel regression models:

$$CSR, CSP, CSP/CFP = \beta_0 + \beta_1\ GOV + \beta_2\ PC + \beta_3\ FIRM_{CONTROL} + \beta_4\ INDUSTRY_{CONTROL} + \beta_5\ PROVINCE_{CONTROL} + \beta_6\ YEAR_{CONTROL} + \varepsilon$$

where the dependent variables reflect a firm's choices related to its CSR practices. The explanatory variables, i.e., government ownership (GOV) and political connections (PC), are the factors that explain the variation in the sample companies' CSR

reporting and performance, and the trade-off between CSRP and CFP. In addition, we controlled for company- and industry-specific effects, and included provinces random effects and year dummies.[17]

The assumptions underlying the regressions were tested for multicollinearity based on Spearman pairwise correlations and the variance inflation factors. Table 3.4 reports the Spearman pairwise correlations between all variables in the main tests. All variance inflation factors (VIF) values are well below the established cut-offs of 5.3 (Hair et al., 1992) and 10 (Ryan, 1997) for each of the independent variables, which indicated the absence of multicollinearity. In addition, in an analysis of the residuals, normality and homoscedasticity were not rejected.

17 To address the fact that the influence of government ownership on firms' CSR reporting strategies, CSRP and CFP-CSRP relations may differ depending on the presence of political connections and vice versa, we also estimated models including both the direct effects of government ownership and political connections and their interaction. The results of the additional tests (reported in Tables B.1 and B.2) did not show significant interaction effects, indicating no combined effects of government ownership and political connections on CSR practices for the Chinese listed firms. These findings suggest that the effects of the two dimensions of political embeddedness on CSR practices do not reinforce each other.

Table 3.3: Summary statistics

Panel A: Total sample

Variables	N	Mean	Median	Std.Dev.	Min	Max
CSR	15,419	0.224	0.000	0.417	0.000	1.000
GOV	15,419	0.394	0.000	0.489	0.000	1.000
PC	15,419	0.475	0.000	0.499	0.000	1.000
SIZE	15,409	14.35	14.154	1.143	7.707	22.29
AGE	15,419	9.204	9.386	6.194	0.000	21.27
ROA	15,418	0.039	0.036	0.064	-0.245	0.243
LEV	15,410	0.463	0.458	0.243	0.041	1.292
GROWTH	15,418	0.163	0.076	0.523	-0.782	3.724
FCF	15,409	-0.001	0.010	0.116	-0.570	0.261
INDEPENDENCE	15,316	0.369	0.333	0.054	0.091	0.800
VISIBILITY	15,419	0.128	0.000	0.460	0.000	11.000
CROSSLISTING	15,419	0.074	0.000	0.263	0.000	1.000

Notes: See Table 3.2 for variable definitions.

Panel B: Subsample of companies that issued a CSR report

Variables	N	Mean	Median	Std.Dev.	Min	Max
RKS	1,866	37.810	34.693	12.272	16.210	88.848
ESG	2,813	20.806	20.661	5.263	7.851	45.455
TQ	3,387	1.520	1.086	1.411	0.068	7.649
PB	3,387	2.885	2.262	2.060	0.590	11.738
GOV	3,447	0.536	1.000	0.499	0.000	1.000
PC	3,447	0.598	1.000	0.490	0.000	1.000
SIZE	3,444	14.644	14.405	1.205	11.892	19.260
AGE	3,447	10.579	11.175	5.843	0.170	21.693
ROA	3,447	0.048	0.039	0.051	-0.092	0.227
LEV	3,444	0.507	0.520	0.216	0.056	0.944
GROWTH	3,447	0.160	0.108	0.358	-0.555	2.099
FCF	3,444	0.010	0.015	0.091	-0.358	0.237
INDEPENDENCE	3,436	0.372	0.333	0.059	0.125	0.800
VISIBILITY	3,447	0.100	0.000	0.385	0.000	6.000
CROSSLISTING	3,447	0.155	0.000	0.362	0.000	1.000

Notes: See Table 3.2 for variable definitions.

Table 3.4: Correlation matrix

Panel A: Total sample

	1	2	3	4	5	6	7	8	9	10	11	12
1. CSR	1.00											
2. GOV	0.16*	1.00										
3. PC	0.13*	0.01	1.00									
4. SIZE	0.15*	0.09*	0.08*	1.00								
5. AGE	0.12*	0.35*	-0.03*	0.16*	1.00							
6. ROA	0.09*	-0.05*	0.07*	0.05*	-0.08*	1.00						
7. LEV	0.10*	0.25*	0.02	0.18*	0.40*	-0.11*	1.00					
8. GROWTH	0.01	-0.02	0.01	0.07*	0.02	0.12*	0.04*	1.00				
9. FCF	0.05*	0.01	0.02*	-0.02	-0.01	0.04*	-0.01	-0.02*	1.00			
10. INDEPENDENCE	0.03*	-0.04*	0.01	0.03*	-0.03*	-0.01	-0.01	0.00	-0.01	1.00		
11. VISIBILITY	-0.03*	-0.05*	-0.02	-0.01	0.04*	-0.07*	0.06*	-0.00	-0.04*	0.01	1.00	
12. CROSSLISTING	0.16*	0.15*	0.08*	0.14*	0.17*	0.02*	0.14*	-0.00	0.00	0.02	-0.04*	1.00

Notes: * Indicates statistical significance at the 1% level. See Table 3.2 for variable definitions.

Panel B: Subsample of companies that issued a CSR report

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
1. RKS	1.00														
2. ESG	0.60*	1.00													
3. TQ	-0.22*	-0.18*	1.00												
4. PB	-0.20*	-0.18*	0.86*	1.00											
5. GOV	0.15*	0.10*	-0.24*	-0.16*	1.00										
6. PC	0.14*	0.09*	-0.04	0.00	-0.05	1.00									
7. SIZE	0.23*	0.08*	-0.35*	-0.19*	0.12*	0.08*	1.00								
8. AGE	-0.01	0.06	-0.23*	-0.11*	0.30*	-0.05	0.20*	1.00							
9. ROA	-0.07*	-0.04	0.55*	0.31*	-0.14*	0.04	-0.16*	-0.12*	1.00						
10. LEV	0.24*	0.15*	-0.63*	-0.21*	0.18*	0.08*	0.44*	0.25*	-0.49*	1.00					
11. GROWTH	-0.01	0.01	0.06*	0.10*	-0.06	0.02	0.07*	-0.03	0.12*	0.05	1.00				
12. FCF	0.01	0.02	0.07*	0.04	-0.03	-0.02	-0.05	-0.02	0.16*	-0.04	-0.04	1.00			
13. INDEPENDENCE	0.01	0.01	0.04	0.02	-0.05	0.05	0.03	-0.05	-0.00	0.01	-0.03	-0.02	1.00		
14. VISIBILITY	-0.02	-0.01	-0.02	0.01	-0.05	-0.03	-0.01	-0.04	-0.04	0.03	0.00	-0.04	-0.03	1.00	
15. CROSSLISTING	0.33*	0.24*	-0.18*	-0.14*	0.12*	0.10*	0.16*	0.10*	-0.03	0.17*	-0.02	0.01	-0.01	-0.06*	1.00

Notes: * Indicates statistical significance at 1% level. See Table 3.2 for variable definitions.

3.4 Results

Table 3.5 reports the results of the multilevel logistic regression models that we used to examine the relationship between political embeddedness and companies' likelihood of issuing a CSR report. Model 1 reports positive and statistically significant associations between political embeddedness, proxied by government

ownership and political connections, and the disclosure of CSR reports. The results provide support for H1, indicating that politically embedded firms are more likely to issue CSR reports than non-politically-embedded firms. Models 2 through 4 show the results of the regression models that we used to examine the relationship between the levels of political embeddedness and the firms' likelihood of issuing CSR reports. The results for Model 2 show a statistically significant and negative relationship between the levels of political embeddedness and CSR disclosure, indicating that compared with central politically embedded firms, local and non-politically embedded firms are less likely to issue CSR reports. These results provide further support for H1. At the same time, they also support H3a, indicating that the effects of central levels of political embeddedness on CSR reporting are stronger than the effects of local levels of political embeddedness. Additionally, the results for Model 3 and Model 4, which use the subsamples of government-owned firms and firms with political connections, respectively, show statistically significantly positive relations between the two measures of political embeddedness and the likelihood of issuing CSR reports, thus providing additional support for H3a.

Table 3.6 reports the results of the multilevel linear regression analyses that examined the relationship between political embeddedness and CSRP, using the RKS and ESG scores as proxies for CSRP. The results for Model 1 and Model 2 show that government ownership and political connections are statistically significantly positively related to CSRP, indicating that the CSRP of politically embedded firms is, on average, higher than the CSRP of firms without political embeddedness. The results thus provide strong support for H2. Model 3 and Model 4 report the results for the hypothesized relation between the level of political embeddedness and CSRP. The statistically significantly negative coefficients of NONGOV and NONPC indicate that, compared to central politically embedded firms, non-politically embedded firms are more likely to have a lower CSRP. These results provide further support for H2. The results for Models 3 and 4 also show that the differences in CSRP between the firms that have political connections at the local level relative to central levels are statistically significantly negative. These results provide support for H3b, indicating that compared to central politically connected firms, firms with local political connections are more likely to have a lower CSRP. However, the results for Model 3 and Model 4 do not show statistically significant relations between levels of government ownership and CSRP. Taken together, the results of Model 3 and Model 4 provide support for H2 and partial support for H3b, indicating that only the level of political connections matters in explaining the variance of firms' CSRP, not the level of government ownership.

Panels A and B of Table 3.7 show the results of the multilevel logistic regression analyses that tested H4, which predicted that for politically embedded firms CSRP is more likely to be negatively related with CFP than for non-politically embedded firms.

Panel A presents the results for the associations between political embeddedness and the CSRP-CFP trade-off, using different proxies for the combinations $CSRP_{High}$ & CFP_{Low} and $CSRP_{Low}$ & CFP_{High}. Panel B reports the results of additional analyses for the different subsamples of politically embedded firms, i.e., firms that are government owned vs. non-government owned, and firm with political connections vs. firms without political connections. The results of Models 1 through 4 in Panel A consistently show positive, predominantly statistically significant relationships between political embeddedness and high CSRP in combination with low CFP, while the results for Models 5 through 8 consistently show that the relations between political embeddedness and combinations of low CSRP and high CFP are negative and mostly statistically significant. These results provide support for H4, indicating that the trade-off effect between CSRP and CFP is stronger for politically embedded firms than for non-politically embedded firms. The additional results in Panel B for the subsamples of the politically embedded firms versus non-politically embedded firms provide further support for H4 in the Model 1 versus Model 2, Model 3 versus Model 4, and Model 7 versus Model 8. Taken together, the results presented in Panel A and B of Table 3.7 indicate that for politically embedded firms, CSRP is more negatively related to CFP than for non-politically embedded firms.

Table 3.5: Effects of political embeddedness on CSR reporting

	Total sample		Sub sample	
	Model 1	Model 2	Model 3	Model 4
GOV	0.696***			
	(7.46)			
PC	0.569***			
	(6.80)			
LOCGOV		-0.520***		
		(-4.10)		
NONGOV		-1.031***		
		(-8.71)		
LOCPC		-0.354***		
		(-3.13)		
NONPC		-0.779***		
		(-7.11)		
GOVLEVEL			0.383***	
			(2.82)	
PCLEVEL				0.338***
				(2.96)
SIZE	0.174***	0.179***	0.295***	0.109**
	(4.21)	(4.33)	(4.82)	(1.98)
AGE	0.034***	0.036***	-0.001	0.048***
	(4.06)	(4.24)	(-0.06)	(4.50)
ROA	5.703***	5.708***	5.973***	6.460***
	(9.23)	(9.26)	(6.11)	(7.17)
LEV	0.862***	0.815***	0.391	1.539***
	(4.24)	(3.99)	(1.29)	(5.22)
GROWTH	-0.119***	-0.125***	-0.140**	-0.101*
	(-2.98)	(-3.10)	(-2.28)	(-1.65)
FCF	0.701***	0.724***	0.730**	0.378
	(3.54)	(3.62)	(2.22)	(1.24)
INDEPENDENCE	0.823	0.800	2.188**	1.794**
	(1.24)	(1.21)	(2.34)	(2.17)
VISIBILITY	-0.201***	-0.198***	-0.287***	-0.269***
	(-3.71)	(-3.71)	(-3.39)	(-2.96)
CROSSLISTING	0.828***	0.791***	0.840***	0.925***
	(5.34)	(5.11)	(4.67)	(4.89)
Industry dummies	Y	Y	Y	Y
Year dummies	Y	Y	Y	Y
Random province effects	Y	Y	Y	Y
Random firm effects	Y	Y	Y	Y
Intercept	-4.377***	-2.843***	-5.220***	-3.456***
	(-5.61)	(-3.58)	(-4.51)	(-3.37)
N	15307	15307	6017	7242
Wald chi2	734.548	752.069	448.729	422.289

Notes: Model 3 is based on the sub-sample of government-owned firms. Model 4 is based on the sub-sample of politically connected firms. ***, ** and * indicate statistical significance at 1 %, 5 %, and 10 % levels respectively (two-tailed), z-values are below the regression coefficients in parentheses. Individual coefficients of the industry dummies, year dummies, and random province and firm effects are not reported for parsimony. See Table 3.2 for variable definitions.

Table 3.6: Effects of political embeddedness on CSRP

Dependent variable	CSRP			
	RKS	ESG	RKS	ESG
	Model 1	Model 2	Model 3	Model 4
GOV	1.757***	0.565***		
	(3.36)	(2.80)		
PC	2.337***	0.659***		
	(4.80)	(3.50)		
LOCGOV			0.414	-0.187
			(0.59)	(-0.67)
NONGOV			-1.639**	-0.703***
			(-2.41)	(-2.67)
LOCPC			-2.118***	-0.585**
			(-3.41)	(-2.39)
NONPC			-3.530***	-0.990***
			(-5.92)	(-4.21)
SIZE	0.360	-0.090	0.363	-0.073
	(1.29)	(-0.85)	(1.29)	(-0.69)
AGE	-0.307***	-0.033*	-0.319***	-0.036**
	(-6.75)	(-1.88)	(-7.02)	(-1.99)
ROA	16.775***	7.098***	15.290***	6.915***
	(2.98)	(3.35)	(2.72)	(3.26)
LEV	11.490***	4.176***	11.174***	4.099***
	(7.82)	(7.36)	(7.58)	(7.22)
GROWTH	-0.647	0.279	-0.574	0.296
	(-0.96)	(1.07)	(-0.85)	(1.13)
FCF	-2.262	-0.233	-2.341	-0.212
	(-0.87)	(-0.24)	(-0.91)	(-0.22)
INDEPENDENCE	5.991	0.198	5.781	0.082
	(1.48)	(0.13)	(1.43)	(0.05)
VISIBILITY	-0.683	-0.127	-0.687	-0.129
	(-1.34)	(-0.57)	(-1.35)	(-0.58)
CROSSLISTING	7.676***	3.625***	7.491***	3.549***
	(10.82)	(9.51)	(10.53)	(9.28)
Industry dummies	Y	Y	Y	Y
Year dummies	Y	Y	Y	Y
Random province effects	Y	Y	Y	Y
Random firm effects	Y	Y	Y	Y
Intercept	21.176***	15.005***	26.207***	16.386***
	(4.25)	(7.82)	(5.21)	(8.46)
N	1862	2804	1862	2804
Wald chi2	721.685	550.245	738.558	557.404

Notes: ***, ** and * indicate statistical significance at 1 %, 5 %, and 10 % levels respectively (two-tailed), z-values are below the regression coefficients in parentheses. Individual coefficients of the industry dummies, year dummies, and random province and firm effects are not reported for parsimony. See Table 3.2 for variable definitions.

3.5 Discussion and conclusion

This study examined whether and how political embeddedness influences the diffusion of CSR practices in China. Specifically, we investigated how government ownership and political connections affect Chinese listed firms' likelihood of issuing CSR reports, firms' underlying CSRP, and its relation with firms' CFP. The results indicate that politically embedded firms, and in particular central politically embedded firms, are more likely to issue CSR reports than non-politically embedded firms. The results also indicate that politically embedded firms, on average, have a higher CSRP than non-politically embedded firms. In addition, the CSRP of firms with central political connections is higher than that of firms with local political connections.[18] The control- and agency-oriented perspectives of political legitimacy explain these findings by suggesting that political embeddedness increases the effectiveness of government-induced CSR policies. More specifically, different types and levels of dependency on the government expose firms to different types of political pressures, which differently drive their CSR-related practices. This study shows that the government can shape firms' CSR practices directly via (majority) ownership and indirectly via politically connected executives. For these reasons, government ownership and political connections can be effective instruments for the diffusion of CSR practices. However, the results also indicate that for politically embedded firms in China, CSRP is more likely to be negatively related to CFP than for non-politically embedded firms. This result indicates that political embeddedness also affects the trade-off with corporate financial performance, representing opportunity costs, undermining the efficiency of government-induced CSR policies. Collectively, the results indicate that in settings with political embeddedness, both effectiveness and efficiency measures have to be taken into account for a holistic evaluation of government-induced policies, such as the diffusion of CSR practices. From an effectiveness perspective, the different types and levels of political embeddedness play considerable but different roles in explaining the diffusion of corporate CSR-related practices. From an efficiency perspective, the results indicate that state interventions involve opportunity costs.

These results have several implications for policy-makers and research related to CSR practices. First, the finding that in China political embeddedness is an important driver of the diffusion of corporate CSR practices and the finding that

18 The results, however, do not indicate that the CSRP of central government–owned firms is higher than that of local government–owned firms. A potential explanation for this finding might be that in recent years the process of reform has deepen more to local government–owned firms. Central and local government–owned firms have to meet minimum levels of CSRP required by regulators and society. For this reason, government-owned firms at the central and local levels were facilitated to be involved in more CSR activities and thus, increase their CSRP, reducing variation in CSR.

firms respond differently due to different types and levels of dependency on the government have policy implications. The Chinese government could apply different CSR policies for politically embedded firms at the central and local levels, and for non-politically embedded firms to more effectively affect firms' strategic CSR choices. However, the findings also emphasize the necessity of taking into account policy-related opportunity costs. If the improvement in the CSRP and the number of firms that publish CSR reports comes at the cost of a statistically significantly decreasing CFP, then the net societal benefit may become negative, thus rendering the policy unfavorable. Second, from a research perspective, the finding that government ownership and political connections both affect companies' CSR practices implies that in research settings in which different types of political embeddedness are present, variation in companies' CSR-related practices cannot be fully captured by studying the effects of only government ownership or only political connections. Additionally, the findings imply that current and future research should continue to make a distinction between different levels of political embeddedness to provide a more fine-tuned picture of the mechanisms behind the effects of political embeddedness.

However, the findings of this study have to be considered in light of several limitations. Two limitations of this study are related to the CSR and political embeddedness proxies. We considered only the likelihood of issuing CSR reports, the CSRP, and the CSRP–CFP relation in our analysis. We did not examine the relation between political embeddedness and other aspects of CSR, such as the credibility of the CSRP information displayed in the CSR reports. Regarding the political embeddedness proxies, the underlying assumption in the empirical section is that government ownership and political connections have uniform effects on companies' strategic CSR choices. However, the degree of political influence might differ among firms. For example, the benefits from political connections could be expected to differ for a member of parliament or a government minister. Further research could make a more refined distinction between types and levels of political embeddedness to increase insight into the role that political embeddedness plays in affecting the diffusion of government policies and signals, such as the promotion of CSR practices in China. Overall, more research is needed for an in-depth analysis of the roles the government plays in facilitating the diffusion of corporate CSR practices. Further research could also use a broader and international firm sample, and include Western settings, to provide greater insight into the external validity of the findings. An improved understanding is important as it may advance our understanding of the conditions that facilitate or inhibit the development of sustainable business practices and the creation of sustainable value.

Table 3.7: Effects of political embeddedness on the CSRP-CFP trade-off

Panel A: Total sample

Dependent:	$CSRP_{High}$ & CFP_{Low}				$CSRP_{Low}$ & CFP_{High}			
	RKS_{high} TQ_{low}	RKS_{high} PB_{low}	ESG_{high} TQ_{low}	ESG_{high} PB_{low}	RKS_{low} TQ_{high}	RKS_{low} PB_{high}	ESG_{low} TQ_{high}	ESG_{low} PB_{high}
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8
GOV	0.513***	0.474***	0.244	0.378**	-0.666***	-0.664***	-0.329**	-0.351**
	(2.98)	(2.79)	(1.60)	(2.46)	(-4.14)	(-4.29)	(-2.34)	(-2.56)
PC	0.668***	0.520***	0.380**	0.202	-0.300**	-0.156	-0.393***	-0.265**
	(3.64)	(2.94)	(2.45)	(1.40)	(-2.06)	(-1.07)	(-2.85)	(-1.96)
SIZE	0.259***	0.326***	0.282***	0.321***	-0.240***	-0.270***	-0.173**	-0.236***
	(2.78)	(3.40)	(3.21)	(3.94)	(-2.78)	(-3.20)	(-2.34)	(-3.18)
AGE	0.027*	0.017	0.016	0.011	0.052***	0.052***	-0.005	0.006
	(1.79)	(1.15)	(1.00)	(0.73)	(3.94)	(3.89)	(-0.37)	(0.47)
ROA	-4.042**	-5.324***	-6.055***	-6.298***	-0.280	1.343	4.140***	5.200***
	(-2.22)	(-3.28)	(-3.43)	(-4.05)	(-0.16)	(0.77)	(2.75)	(3.42)
LEV	3.943***	1.119**	4.277***	1.185***	-4.926***	-1.836***	-4.613***	-1.384***
	(7.01)	(2.30)	(7.73)	(2.76)	(-10.75)	(-3.97)	(-10.57)	(-3.18)
GROWTH	0.033	-0.328*	-0.138	-0.424***	0.327*	0.398**	0.072	0.066
	(0.17)	(-1.67)	(-1.00)	(-3.00)	(1.83)	(2.39)	(0.51)	(0.49)
FCF	1.282*	1.005	-0.037	0.293	1.245*	1.006	-0.932*	-0.685
	(1.82)	(1.63)	(-0.07)	(0.58)	(1.79)	(1.49)	(-1.74)	(-1.42)
INDEPENDENCE	0.264	0.384	1.047	0.575	1.473	0.692	1.504	0.931
	(0.19)	(0.30)	(0.72)	(0.40)	(1.16)	(0.56)	(1.44)	(0.91)
VISIBILITY	-0.063	-0.085	-0.209*	-0.265*	0.156	0.161	-0.123	-0.064
	(-0.45)	(-0.54)	(-1.67)	(-1.94)	(1.26)	(1.37)	(-0.80)	(-0.50)
CROSSLISTING	0.760***	0.807***	-0.526*	-0.581**	-0.455	-0.600*	-1.367***	-2.032***
	(3.19)	(3.52)	(-1.85)	(-2.13)	(-1.42)	(-1.92)	(-4.11)	(-5.28)
Industry dummies	Y	Y	Y	Y	Y	Y	Y	Y
Year dummies	Y	Y	Y	Y	Y	Y	Y	Y
Random province effects	Y	Y	Y	Y	Y	Y	Y	Y
Random firm effects	Y	Y	Y	Y	Y	Y	Y	Y
Intercept	-9.880***	-8.446***	-9.851***	-7.801***	6.100***	4.362***	5.538***	4.052***
	(-5.27)	(-4.61)	(-5.88)	(-5.08)	(3.83)	(2.75)	(4.05)	(2.99)
N	3236	3246	3390	3386	3260	3250	3382	3433
Wald chi2	334.553	340.606	228.259	167.006	405.946	253.328	338.852	184.883

Notes: ***, ** and * indicate statistical significance at 1 %, 5 %, and 10 % levels respectively (two-tailed), z-values are below the regression coefficients in parentheses. Individual coefficients of the industry dummies, year dummies, and random province and firm effects are not reported for parsimony. See Table 3.2 for variable definitions.

Panel B: Subsamples of companies that are politically embedded

Sub samples:	Politically embedded firms vs non-politically embedded firms							
	GOV=1	GOV=0	GOV=1	GOV=0	PC=1	PC=0	PC=1	PC=0
Dependent:	TQ		PB		TQ		PB	
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8
RKS	-0.007***	0.001	-0.019***	-0.007	-0.003	-0.006	-0.016***	-0.012*
	(-2.69)	(0.25)	(-4.15)	(-1.11)	(-1.09)	(-1.64)	(-3.70)	(-1.79)
GOV					-0.249***	-0.244***	-0.405***	-0.428***
					(-4.08)	(-3.05)	(-3.83)	(-3.02)
PC	-0.075	-0.027	-0.122	-0.103				
	(-1.39)	(-0.38)	(-1.17)	(-0.87)				
SIZE	-0.200***	-0.153***	-0.455***	-0.420***	-0.123***	-0.272***	-0.361***	-0.543***
	(-6.60)	(-3.65)	(-7.81)	(-6.00)	(-3.79)	(-6.18)	(-6.45)	(-6.97)
AGE	0.003	-0.019***	0.007	-0.024**	-0.015***	-0.000	-0.014	0.001
	(0.57)	(-2.99)	(0.70)	(-2.32)	(-2.67)	(-0.07)	(-1.46)	(0.05)
ROA	7.631***	9.265***	12.870***	14.218***	10.649***	5.582***	16.825***	8.600***
	(11.36)	(12.12)	(9.97)	(11.18)	(15.50)	(7.12)	(14.14)	(6.21)
LEV	-2.161***	-2.980***	0.672**	0.291	-2.787***	-2.530***	0.097	0.369
	(-12.61)	(-13.94)	(2.04)	(0.82)	(-14.93)	(-12.14)	(0.30)	(1.00)
GROWTH	0.041	0.173*	0.280*	0.385**	0.156*	0.113	0.463***	0.243
	(0.53)	(1.86)	(1.90)	(2.48)	(1.95)	(1.15)	(3.32)	(1.41)
FCF	-0.488	0.494	-0.764	0.445	-0.170	0.081	-0.816	0.520
	(-1.64)	(1.39)	(-1.34)	(0.75)	(-0.54)	(0.22)	(-1.50)	(0.80)
INDEPENDENCE	0.246	1.554***	-0.015	2.731***	1.275***	0.753	2.214***	0.608
	(0.52)	(2.76)	(-0.02)	(2.91)	(2.70)	(1.19)	(2.71)	(0.55)
VISIBILITY	0.011	-0.007	0.126	-0.053	0.056	-0.044	0.067	0.046
	(0.18)	(-0.10)	(1.12)	(-0.45)	(0.93)	(-0.57)	(0.64)	(0.34)
CROSSLISTING	-0.189***	-0.443***	-0.261*	-0.732***	-0.287***	-0.322***	-0.448***	-0.436**
	(-2.62)	(-3.59)	(-1.89)	(-3.57)	(-3.56)	(-2.63)	(-3.21)	(-2.02)
Industry dummies	Y	Y	Y	Y	Y	Y	Y	Y
Year dummies	Y	Y	Y	Y	Y	Y	Y	Y
Random province effects	Y	Y	Y	Y	Y	Y	Y	Y
Random firm effects	Y	Y	Y	Y	Y	Y	Y	Y
Intercept	6.421***	5.774***	11.653***	10.163***	5.247***	8.269***	9.756***	13.871***
	(11.78)	(7.70)	(11.13)	(8.14)	(9.19)	(10.25)	(9.88)	(9.68)
N	964	867	964	867	1098	733	1098	733
Wald chi2	1017.902	1372.924	425.912	593.513	1657.667	841.831	800.096	311.436

Notes: ***, ** and * indicate statistical significance at 1 %, 5 %, and 10 % levels respectively (two-tailed), z-values are below the regression coefficients in parentheses. Individual coefficients of the industry dummies, year dummies, and random province and firm effects are not reported for parsimony. See Table 3.2 for variable definitions.


M&A

Chapter 4

The effects of political embeddedness on Chinese cross-border mergers and acquisitions[19]

19 This chapter is based on a joint paper with Gerhard Kling and Utz Weitzel, *The effects of political embeddedness on Chinese cross-border mergers and acquisitions*. Current status: under review.

4.1 Introduction

Mergers and acquisitions (M&As) are important strategic corporate initiatives enabling firms to extend their current businesses, enter markets and leverage capabilities (Bhagat et al., 2011). In particular, cross-border M&As are a dominant form of foreign direct investment (FDI) and closely linked to internationalization strategies (Kling et al., 2014; Shimizu et al., 2004). Are Chinese companies, both state-owned and private, at the brink of becoming multinational enterprises (MNEs)? What are the drivers of cross-border M&As? What makes them successful? And above all, what is the role of political embeddedness?

After decades of economic reforms and institutional transitions starting in the late 1970s, China is the world's second largest economy (Chen et al., 2011b; Child and Rodrigues, 2005; Cui and Jiang, 2012; Delios et al., 2008; Quer et al., 2012) and a trading partner of many major economies, including the EU, the US, and Japan (Gao et al., 2010). Recently, China has accelerated its pace regarding outward foreign direct investment (OFDI) (Deng, 2009; Zhang et al., 2011). Chinese OFDI was USD 59 billion in 2010, which has risen to USD 170.11 billion in 2016 (China Ministry of Commerce, 2017). The surging value of OFDI makes China the world's third largest foreign investor (UNCTAD, 2016). Especially, Chinese enterprises have adopted cross-border M&As as a major mechanism of OFDI (Hong and Sun, 2006; Zhang and Ebbers, 2010) and employed international listing as an important channel to raise capital to finance their international expansion.

In sharp contrast to market-based developed economies, dramatic changes have taken place in the Chinese economic system which has hitherto been characterized by centralized political control, dominance of state ownership in big businesses, and bureaucratic intervention (Chen and Young, 2010; Hong and Sun, 2006; Morck et al., 2008). Although China has recently been experiencing the change from a centrally planned to a market-based economy through liberalization and privatization (Child and Tse, 2001; Gao et al., 2010; Peng and Heath, 1996; Tan and Tan, 2005), such transition is a challenging and enduring process filled with institutional difficulties such as unpredictable regulatory changes, lack of effective legal protection, underdeveloped market factors and inefficient market intermediaries because of pervasive government intervention and imperfect market mechanism (Nee, 1992; Wu and Chen, 2014; Yiu et al., 2007). Many publicly traded Chinese companies have been transformed from government entities, and the government is still the majority shareholder and thus maintains ownership and control of these firms (Chen et al., 2011b). Furthermore, extensive political connections between the government and executives of large firms are still the norm (Wu et al., 2012b, 2012c). There are many examples, where corporate executives are central or local government officials themselves (Ma and Parish, 2006). Consequently, the significant influence of the

government has still remained a striking feature of the economy (Lee et al., 2014), especially FDI by Chinese MNEs (Kang and Jiang, 2012). Moreover, the government's stance on OFDI regulations has also continuously been evolving during the past three decades from tight control to active sponsoring and even direct funding (Buckley et al., 2007; Liu and Li, 2002). All these features make China a very well suited empirical setting to capture the effects of governmental signals on firms' behavior and decision-making (Cui and Jiang, 2012).

Given the recent surge in OFDI, studies on China's OFDI in general (Hong and Sun, 2006) and cross-border M&As in particular (Kling and Weitzel, 2011) do not capture the period after 2008. Existing research on the drivers of Chinese diversification strategies (Buckley et al. 2007; Child and Rodrigues, 2005; Deng, 2009; Gao et al., 2010; Lu et al., 2011; Morck et al, 2008; Peng et al., 2007; Rui and Yip, 2008; Sun et al., 2012; Wang et al., 2012a; Wu and Chen, 2014; Zheng et al., 2016) and the determinants of M&A success (Liao and Yu, 2012; Ma et al., 2013; Zhang and Ebbers, 2010; Zhang and He, 2014; Zhang et al., 2011; Zhong et al., 2013) approach these topics more generically, without accounting for the peculiarities of the Chinese institutional environment (Child and Rodrigues, 2005; Kling and Weitzel, 2011), except for a few studies such as Cui and Jiang (2009, 2012), Du and Boateng (2015) and Kling and Weitzel (2011). However, these studies only consider state ownership overlooking other forms of political embeddedness. This study tries to capture a wider range of dimensions of political influence to assess their impact on cross-border M&A activity and their success.

Building on prior work such as Kling and Weitzel (2011) and a Chinese specific "strategy tripod", we develop a theoretical framework centered around an institution-based view. This framework incorporates resource- and industry-based views. We contend that institutional constraints, and consequential resource allocation and industry traits, influence both politically-embedded enterprises (PEEs) and firms without political embeddedness (NPEEs). Using a panel data set with 30,314 firm-year observations of publicly traded firms in China from 2000 to 2015, we find that SOEs are less likely to conduct cross-border M&As than non-SOEs. In addition, government-led M&As are less likely to achieve success, proxied by cumulative abnormal return (CAR), market-to-book ratio (MTB) and operational risk measures. The level of government ownership matters, in that central SOEs (i.e. SOEs controlled by the central government) conduct more cross-border M&As and benefit more from M&A activities than local SOEs. Political connections of firms' executives, as another dimension of political embeddedness, exhibits similar but insignificant effects on firms' international diversification choices and M&A success. This indicates that relative to executives' political connections, government ownership is the major channel through which political embeddedness operates on firms' internationalization strategies and M&A success.

Our contribution is threefold. First, this paper extends the international business literature by analyzing the institutional determinants of Chinese acquirers' propensity for going abroad and M&A success. This paper extends Kling and Weitzel (2011) by showing that firms' political embeddedness, especially local political embeddedness, has a negative impact on firms' internationalization and M&A performance. Second, this paper adds to the literature in political economy by enriching the findings of the effects of political embeddedness in emerging markets. The literature on the effects of Chinese political embeddedness examines either government ownership (Wei and Varela, 2003; Wei et al., 2005; Xu and Wang, 1999) or political connection of executives (Fan et al., 2007; Li et al., 2008; Tu et al., 2013; Wu et al., 2012c). An exception is Chen et al., (2011), which treats both government ownership and political connection of executives as forms of 'government intervention' and shows that government intervention reduces firm value. The third contribution lies in the finding that the level of political embeddedness, i.e. local versus national, exerts a different influence on firms' geographical diversification. Studies that regard the state as a single entity overlook conflicting agendas of various levels of government.

The remainder of this paper is structured as follows. First, we develop a conceptual framework and hypotheses. Next, we describe the research method and discuss our findings. Finally, the conclusion re-examines our results and indicates directions for further research.

4.2 Research background and hypotheses

4.2.1 The conceptual framework

In line with Kling and Weitzel (2011), our study refers to cross-border M&As as entry mode and does not consider greenfield investments. For large-scale longitudinal studies, access to reliable data on greenfield investments is challenging, whereas various data sources capture cross-border M&As. Empirically, cross-border M&As have been the dominant form of OFDI, reaching up to 83% in certain years (UNCTAD, 2000). Hence, the decision to internationalize overlaps with the decision to acquire foreign targets (Kling and Weitzel, 2011, p.358). Moreover, the ownership-location-internalization (OLI) framework that has been predominantly used for analyzing cross-border M&As (Williamson, 1975) is not relevant for the analysis of domestic versus cross-border transactions (Kling et al., 2014), because it is only applicable in the context of OFDI into host countries (Rugman, 2010). Moreover, the OLI framework provides only limited insights into the outcome of M&A and its implementation (Shimizu et al., 2004).

Compared with developed markets, the institutional environment is one of the most salient features and peculiarities of emerging economies (Gao et al., 2010). Accordingly, the institution-based view is the most suitable theoretical perspective for analyzing and understanding business strategy in emerging or transitional economies (Buckley et al., 2007; Child and Rodrigues, 2005; Du and Boateng, 2015; Hoskisson et al., 2000; Kang and Jiang, 2012; Meyer and Peng, 2016; Peng et al., 2008, 2017; Quer et al., 2012). Based on this notion and consistent with Cui et al. (2011), Gao et al. (2010), Peng et al. (2008) and Sun et al. (2012), this study adopts the "strategy tripod" perspective – namely the institution-, resource- and industry-based views due to the following considerations. First, since these three perspectives are based on different underlying assumptions and boundary conditions, each perspective provides only a partial explanation for firms' cross-border expansion (Wang et al., 2012a). Only using one or two perspectives might not fully capture the complete mechanisms (Gao et al., 2010; Sun et al., 2012). Second, because these three perspectives are interdependent (Wang et al., 2012a), it is more useful to investigate the comprehensive effects based on an integrated framework. Third, the "strategy tripod" perspective not only fully captures the special driving forces behind Chinese OFDI (Cui et al., 2011, p.484), but gives better explanations for M&A success as well.

Different from the existing literature, which treats the three views in parallel, we argue that in China, the institutional environment is decisive in the economy and thus plays a key role in firms' decision making. The resource-based view suggests that variation of managerial decisions in internationalization is a function of inter-firm resource heterogeneity driven by motives of efficiency and competitiveness (Insead and Chatain, 2008; Wang et al., 2012a). The industry-based view stresses that the key principle of competitive strategy formulation is a firm's relationship to the industry environment in which the firm competes (Lu et al., 2011). In China, both firm-specific resources and industry characteristics are closely related to and even dependent on the institutional environment. Firms' strategic choices not only reflect their capabilities and industry conditions, but also represent the formal and informal constraints of their institutional environments (Hitt et al., 2004; Hoskisson et al., 2000; Peng et al., 2008; Wu and Chen, 2014). Accordingly, the institutional theory suggests that the institutional environment in which a firm operates significantly shapes the efficacy of its operations and performance (Cui and Jiang, 2012; Meyer et al., 2009; Peng et al., 2008; Wang et al., 2012a; Wright et al, 2005; Wu and Chen, 2014). This enables us to explain the internationalization of companies from emerging economies (Quer et al., 2012; Wright et al., 2005). Especially in the context of China, where political embeddedness dominates, it is more useful to adopt the institution-based view as an overarching concept within which the resource- and industry-based views function mediating the influence of the political domain, which shape the propensity of cross-border M&As and their success.

4.2.2 Political embeddedness and propensity for conducting cross-border M&As

One of the most distinct characteristics of the Chinese institutional environment is that the government maintains strong influence on outward FDI (Cui and Jiang, 2012; Deng, 2009; Morck et al., 2008). Prior studies found that external institutional constraints and pressures can influence firms' strategic choices in OFDI (Brouthers, 2002; Chan and Makino, 2007; Cui and Jiang, 2012; Gao et al., 2010; Meyer et al., 2009; Nee, 1992). Based on prior evidence, one can argue that Chinese institutional characteristics constrain cross-border M&As conducted by PEEs while propelling those conducted by NPEEs.

To analyze how Chinese political embeddedness affects the propensity of PEEs conducting cross-border M&As, we follow the framework developed by Cui and Jiang (2012). First, from the home country's view, the Chinese government exercises pervasive capital control for OFDI (Cui and Jiang, 2010; Morck et al., 2008). The Chinese PEEs, especially central PEEs, dominate so-called critical and strategic industries such as energy, natural resources, transport, heavy industry, aviation, and telecommunications (Schüler-Zhou and Schüller, 2009). Due to their key status in the economy and inherent bonds with the government, PEEs are confronted with serious institutional constraints (Deng, 2009; Morck et al., 2008). Many regulations and governmental agencies such as the Chinese Ministry of Commerce regulate and scrutinize OFDI strictly. The main purposes of these institutional arrangements are to direct PEEs' investment activities to adhere to the government's national investment strategies (Cui and Jiang, 2012) and to be in line with national interests (Cui and Jiang, 2012; Deng, 2009). Thus, compared with NPEEs, PEEs face an additional constraint when conducting cross-border M&As because in many cases they need to invest and deploy resources in specific areas due to either government requirements or their indebtedness to politicians (Vanhonacker, 2004; Wu and Chen, 2014). As such, cross-border activities of PEEs are confronted with stricter scrutiny and control by the government (Wu and Chen, 2014). Furthermore, politically embedded managers lack the capabilities and willingness to conduct cross-border M&As. These managers are mostly appointed by the government (Fan et al., 2007; Wu et al., 2012b) and thus retain their connections to the bureaucratic command system (Delios et al., 2008). Because of the indigenous political background, they tend to lack the experience and capabilities to deal with organizational and managerial complexities that come with international diversification (Delios et al., 2008; Fan et al., 2007; Teece, 2014). Moreover, these executives usually have complex goals such as protecting their political career and personal wealth (Faccio, 2006; Li et al., 2008; Wu et al., 2012c). Thus, compared with their counterparts in the private sectors, politically embedded managers are more likely to be "extra conservative" and risk averse (Nee, 1992; Teece, 2014) when selecting cross-border projects, as

they are confronted with dual risks - both political risk and economic risk (Delios et al., 2008). Second, from the host country's perspective, political embeddedness often conveys ideological and cognitive motivations such as "national pride" in the course of conducting OFDI (Hope et al., 2011). Besides, PEEs are often associated with the image of bureaucratic practice and inefficiency (Chen et al., 2011b; Xu and Wang, 1999), and are usually perceived by host-country institutions not only as business entities but also as political actors (Cui and Jiang, 2012). The state-driven cross-border M&As by PEEs are thus suspected of having political agendas that do not necessarily benefit the commercial interests of shareholders (Chen and Young, 2010; Zou and Adams, 2008), or may even conflict with the business interests of local firms and distort competition in the host country (Globerman and Shapiro, 2009; He and Lyles, 2008; Zhang et al., 2011). Hence, cross-border M&As conducted by PEEs might stimulate political sensitivity and public concerns in host countries (Cui and Jiang, 2012). Consequently, these firms undergo strict scrutiny or even resistance by host-countries' regulatory institutions, which create strong institutional barriers for Chinese PEEs to conduct cross-border M&As.

Yet, the institutional environment could also promote the internationalization of NPEEs. We argue that, under the Chinese institutional environment, there are two motives for NPEEs to conduct cross-border M&As. The first motive for NPEEs to go global is to reach new markets and seek growth (Deng, 2009; Hong and Sun, 2006; Quer et al., 2012) as the domestic market is dominated by government-supported PEEs and has created a very competitive environment for NPEEs (Child and Rodrigues, 2005; Khanna and Palepu, 2006; Lu et al., 2011). It is also characterized by weak legal system and poor protection for property rights (Delios et al., 2008), which makes it harder for NPEEs to grow healthily. Facing institutional and market constraints at home, NPEEs can use OFDI as a route escaping from the turbulence and uncertainty of the domestic institutional environment (Deng, 2009; Ramasamy et al., 2012; Witt and Lewin, 2007), avoiding cut-throat competition (Cui et al., 2011; Wiersema and Bowen, 2008), introducing new products and accessing new innovations in the host market (Quer et al., 2012). Second, going global provides NPEEs with more (strategic) resources and assets (Deng, 2009; Wong and Chan, 2003). Due to institutional constrains, domestic policies of capitals such as land, finance, natural resources and subsidies are much less preferential for NPEEs (Child and Rodrigues, 2005). Thus, cross-border M&As are effective springboards by NPEEs to acquire or buy strategic assets, or absorb managerial know-how (Quer et al., 2012) and operational knowledge (Schüler-Zhou and Schüller, 2009) to compensate for their domestic competitive weaknesses and to compete more effectively against global rivals (Deng, 2009; Luo and Tung, 2007; Rui and Yip, 2008). Furthermore, as Peng et al. (2004) contend, NPEEs generically possess managerial incentive to pursue innovative and efficiency-seeking strategies. Compared with

their politically embedded peers, NPEEs are young and have flexible organizational and governance structures (Bai et al., 2006). Firm strategies of NPEEs are often characterized by aggressive entrepreneurship (Peng et al., 2007) and having a focus on innovation and change (Delios et al., 2008). These firm-specific characteristics act as pulling forces driving NPPEs to conduct cross-border M&As.

To sum up, Chinese domestic institutional constraints, and their consequential resource and industry peculiarities refrain PEEs from conducting cross-border M&As and, at the same time, propel NPEEs to go global. Hence, we propose the following hypothesis.

Hypothesis 1: Compared to NPEEs, Chinese PEEs conduct less cross-border M&As.

4.2.3 Political embeddedness and M&A success

Studies show a negative influence of political embeddedness on firm value of PEEs, as PEEs tend to be politically rather than commercially motivated (Dewenter and Malatesta, 2001; Du and Boateng, 2015; Fan et al., 2007; Li et al., 2008; Tu et al., 2013; Wei and Varela, 2003; Wei et al., 2005; Wu et al., 2012a; Xu and Wang, 1999). In the Chinese context, the goals of PEEs are more complex (Chen et al., 2011b; Shleifer, 1998). Tightly controlled by the government, these politically embedded conglomerates are vehicles to revitalize China's loss-making enterprises and absorb unemployed workers, rather than autonomously operated enterprises. Economic missions, such as creating national champions and sustaining national economy are much more important than commercial goals. Social goals such as providing employment, developing regional economies and maintaining social stability and fiscal health motivate the government to compete for resources (Chen et al., 2011b; Lin et al., 1998; Xia and Fang, 2005). Meanwhile, politically embedded leaders are motivated to accomplish their own political and personal goals such as enhancing their political capital and promotional potential (Chen et al., 2011a; Li and Zhou, 2005; Lin et al., 1998; Wu et al., 2012b, 2012c). M&A activities initiated by PEEs are appropriate means by which the government or political leaders mobilize resources and achieve such goals. Thus, politically driven M&As usually diverge from the firms' commercial goals (Brockman et al., 2013; Sun et al., 2010). In addition, serious agency problem (Delios et al., 2008; Zou and Adams, 2008) and lack of monitoring mechanism (Chen and Young, 2010) caused by institutional deficiency exacerbate the alleged value-destroying effect of political embeddedness (Cui and Jiang, 2012). By contrast, the agency problems between shareholders and managers are less severe in NPEEs (Dewenter and Malatesta, 2001; Shleifer, 1998) and thus firm value maximization is the primary interest of non-politically connected managers (Delios

et al., 2008; Xu and Wang, 1999). The choices of international diversification made by NPEEs are more consistent with maximizing shareholder value and corporate development. For these reasons, we hypothesize the following.

Hypothesis 2: Compared to NPEEs, Chinese PEEs benefit less from M&As.

4.2.4 The level of political embeddedness

In China, the regulatory environment for firms owned by the central government differs from that for firms owned by local governments (Wang et al., 2008b). Furthermore, different levels of government play different roles in the economy (Du and Boateng, 2015; Sun et al., 2010). We argue that under the theoretical framework of the "strategy tripod", different levels of political embeddedness affect both the motives and the capabilities of firms to conduct cross-border M&As and their success as well.

In China, the central government dominates the economy by issuing regulatory policies and delegating executive power to its local subordinates. Thus, different levels of political embeddedness in China might have different or even divergent interests and goals due to this principal-agent relationship (Sun et al., 2010; Wang et al., 2008b). Central PEEs are more tightly connected with the interests of the whole country, and are thus more concerned with globalization, openness and the integration of the country into the world economy (Child and Rodrigues, 2005). The operational plans of central PEEs' have to stick to the national development blue prints. In many cases, the attempts of cross-border M&As are even initiated by the central government for national developing and strategic purposes. Thus, under the same scrutinizing system, it would be easier for central PEEs to get authorization from the central government and related regulatory agencies for their cross-border M&A activities (Cantwell et al., 2010; Pan et al., 2014; Wang et al., 2012b). By contrast, local PEEs are less likely involved in globalization and benefit less from M&A activities due to several institutional peculiarities of their own. First, local PEEs lack the motives to conduct cross-border M&As. Local PPEs are self-sufficient in terms of financial resources, preferable policy treatment and political bailouts due to their natural ties with the government (Chen et al., 2011a, 2011b; Dewenter and Malatesta, 2001; Shleifer, 1998; Tu et al., 2013; Wu et al., 2012b, 2012c). Unlike privately owned firms, local PEEs face less institutional constraints on the domestic market and thus have less need to compete for resources abroad. Also, local PPEs would be less likely to receive administrative commands to conduct cross-border M&As because those cross-border projects related to national strategies and initiated by the central government are mostly undertaken by central PEEs. For local PEEs, the marginal benefits of cross-border M&As are far less than the marginal costs as such activities

would bring extra economic and political risks to the firm and local politicians (Wang et al., 2012b). Thus, self-interested local politicians would be extra reluctant to voluntarily choose high-risk cross-border projects. Second, as Du and Boateng (2015) find, the quality of the institution may affect the M&A process and firm value. The lower quality of local government institutions might reduce benefits from M&As. As agents of the central government, local governments assume a heavy policy burden to boost the local economy, eliminate local unemployment and maintain local societal stability (Shleifer, 1998; Xu and Wang, 1999). Thus, local government leaders possess stronger motives to compete with each other in grabbing resources for social, political and personal purposes (Cheung et al., 2010; Faccio, 2006; Li et al., 2008; Wu et al., 2012a) and thus have more preferences in uplifting local fiscal revenues (Li and Zhou, 2005; Lin et al., 1998). The M&As that are mandatorily conducted by local PPEs are one of the most 'efficient' vehicles for local government officials to boost local GDP and hit the appraisal target for promotion so as to enhance their own political career. As a result of market reformations and restructuring of the power distribution from the central government, local governments tend to be more autonomous in fiscal matters (Xia and Fang, 2005), which enables local governments to over-invest in projects. Moreover, local monitoring systems are incomplete and inefficient, enabling local PEEs to conduct unjustified M&As. Consequently, those M&As conducted by local PEEs are mostly unnecessary and potentially value destroying.

Apart from institutional peculiarities of local PEEs, the resource-based view propounds that firms can attain competitive advantage if they possess resources not held by others (Wernerfelt, 1984). These firm-specific variables that improve access to resources and capabilities translate into competitive advantage, which in turn stimulates internationalization (Kling and Weitzel, 2011). In China, different levels of political embeddedness provide access to resources and capital (Sun et al., 2010). Central political embeddedness provides firms with better access to financial resources, policy preferences and political assistance due to "natural ties" with the central government (Buckley et al., 2007; Cheung et al., 2010; Cui and Jiang, 2012; Delios et al., 2008; Vaaler and Schrage, 2009; Wang et al., 2012b). In addition, top managers appointed by the central government usually maintain strong connections with central government officials (Delios et al., 2008; Li and Zhang, 2007). Compared with local firms, they enjoy much greater network advantages and receive support and even protection from the central government (Li and Zhang, 2007; Luo and Junkunc, 2008; Xu et al., 2006). Moreover, different government interests and institutional arrangements at different levels may also affect how firms accumulate and manage knowledge and resources (Mahmood and Rufin, 2005). As such, central PEEs obtain scarce resources, privileged industrial development information about foreign market and preemptive opportunities that enhances the likelihood of

internationalization through cross-border M&As (Cui and Jiang, 2009; Cui et al., 2011; Gao et al., 2010; Kling and Weitzel, 2011; Lu et al., 2011; Wang et al., 2012b; Wu and Chen, 2014). In addition, central PEEs possess the ability to extract more value from M&A, for synergies can be realized easier, and better access to resources provides additional synergies (Kling and Weitzel, 2011).

Besides, Kling and Weitzel (2011) also find that firms with better internal and external corporate governance mechanisms conduct more cross-border M&As and exhibit better value creation potential from M&As because they have easier access to foreign markets, and investors have more trust in their quality of governance. This notion also leads to the expectation that central political embeddedness might enhance internationalization and benefit from it more than local ties as central PEEs are exposed to stronger internal and external governance. Both the central government and regulatory institutions such as the State-owned Asset Supervision and Administration Commission (SASAC) and China Securities Regulatory Commission (CSRC) exercise considerable administrative control over central PEEs. In addition, central politically connected executives receive more public attention from the society and media nationwide (Chen et al., 2011b; Wu et al., 2012c), which in turn strengthens the quality of internal governance and increases the chances of conducting cross-border M&As and their value creation potential. Hence, we formulate the following hypotheses.

Hypothesis 3: Compared to central PEEs, Chinese local PEEs conduct less cross-border M&As.

Hypothesis 4: Compared to central PEEs, Chinese local PEEs benefit less from M&As.

4.3 Data, variables and methods

4.3.1 Sample and data

The M&A deal-related data are extracted from Thomson Reuters Financial M&A database (SDC database). Our sample section criteria are as follows: (1) acquisitions announced between January 1st, 2000 and December 31st, 2015; (2) Chinese acquirers that are publicly listed on Chinese mainland stock exchanges, i.e. Shanghai and Shenzhen; (3) where the transaction value of the deal is recorded in the database. This creates a dataset of 7,164 domestic and cross-border transactions by Chinese mainland acquirers. Political embeddedness data refer to government ownership and executives' political connections. Government ownership data, financial data and data of firm-specific variables are downloaded from the China Stock Market

and Accounting Research (CSMAR) database, which contains historical data from annual reports of Chinese listed companies. Data on political connections are manually extracted from the resumes of firms' directors, supervisors and managers. Finally, our unbalanced panel dataset includes 30,314 firm-year observations.

4.3.2 Political embeddedness

Political embeddedness is proxied by government ownership and executives' political connections. To measure government ownership, we assess whether the government has de facto control. The government has de facto control if it directly and/or indirectly – through pyramidal structures – holds the majority of shares (Wang et al., 2008b; Xia and Fang, 2005). Subsequently, we create a dummy labeled *gov* that takes the value 1 if the government has control right, and 0 otherwise.

Table 4.1: Variable definitions

Variable	Description
M&A success	
car	Cumulative abnormal return, computed as the mean of the CARs calculated with the following three models: 1) CAPM; 2) Modified Market Return Model; 3) Constant Mean Return Model.
mtb	Market to book ratio, computed as share market value divided by the book value of total assets.
risk	Operational risk exposure, computed as the volatility of cash flows.
Deal-related variables	
crossborder	Cross-border M&A dummy. The value is 1 if an M&A deal is cross-border; 0 otherwise.
volcrossborder	Cross-border M&A deal volume.
completion	M&A completion status dummy. The value is 1 if an M&A deal is closed; 0 otherwise.
attitude	Acquirer attitude dummy. The value is 1 if the attitude of the acquirer is friendly; 0 otherwise.
divestiture	Divestiture dummy. The value is 1 if an M&A deal is a divestiture; 0 otherwise.
cashmerger	Cash payment dummy. The value is 1 if an M&A deal is disbursed with cash; 0 otherwise.
tglist	Public status dummy of the target firm. The value is 1 if the target firm is publicly traded; 0 otherwise.
horizontal	Horizontal or vertical M&A dummy. The value is 1 if the acquirer and the target share the same SIC code; 0 otherwise.
Political embeddedness variables	
gov	Government ownership dummy. The value is 1 if the de facto owner of a firm is the government; 0 otherwise. The government has de facto ownership if it holds the most shares directly and indirectly.
locgov	Local government ownership dummy. The value is 1 if the de facto owner of a firm is the local government; 0 otherwise.
pc	Political connection dummy. The value is 1 if one if a firm's directors, supervisors or top managers is or was: 1) a government official or 2) a representative of National People's Congress (NPC) or 3) a member of Chinese People's Political Consultative Conference (CPPCC); 0 otherwise.

Variable	Description
locpc	Local political connection dummy. The value is 1 if a firm has local political connection; 0 otherwise.
Firm-specific variables	
size	Firm size, computed as the natural logarithm of total assets.
roa	Return on assets, computed as net income divided by total assets.
age	Company age, proxied by the duration from the Initial Public Offering (IPO) to the sample year.
lev	Financial leverage, computed as total liabilities divided by total assets.
growth	Total assets growth rate.
fcfrate	Free cash flow rate, computed as the sum of net profit, interest expenses and non-cash expenses minus the sum of the addition of working capital and capital expenditure.
independent	Proportion of independent directors on board, computed as the number of independent directors divided by total number of directors on board.
mgtshare	Management share percentages.
hhi10	Ownership concentration, computed as the Herfindahl–Hirschman Index of the first ten shareholdings.
board	Board size, computed as the number of directors on board.
duality	The duality dummy of chairman and CEO. The value is 1 if the CEO and chairman are the same person; 0 otherwise.
exchange	Stock exchange dummies, including Shanghai Main Board, Shenzhen Main Board, Small and Medium Enterprise Board and Growth Enterprise Market.
intershare	International shareholding dummy. The value is 1 if a firm is listed both domestically and overseas; 0 otherwise.
industry	Industry dummies, including finance, industry and manufacturing, real estate, commercials, comprehensive and public utility.
year	Year dummies, from 2000 to 2015.

To assess political connection, consistent with prior research (Chen et al., 2011a; Li et al., 2008; Tu et al., 2013; Wu et al., 2012b, 2012c), we create a dummy denoted *pc*, taking the value 1 if a firm is identified as being politically connected, and 0 otherwise. A company is defined as politically connected if at least one of its directors, supervisors or top executives (CEO, president, vice-president, chairman, or secretary) is or was: (1) a government official or (2) a representative of the National People's Congress (NPC) or (3) a member of the Chinese People's Political Consultative Conference (CPPCC).

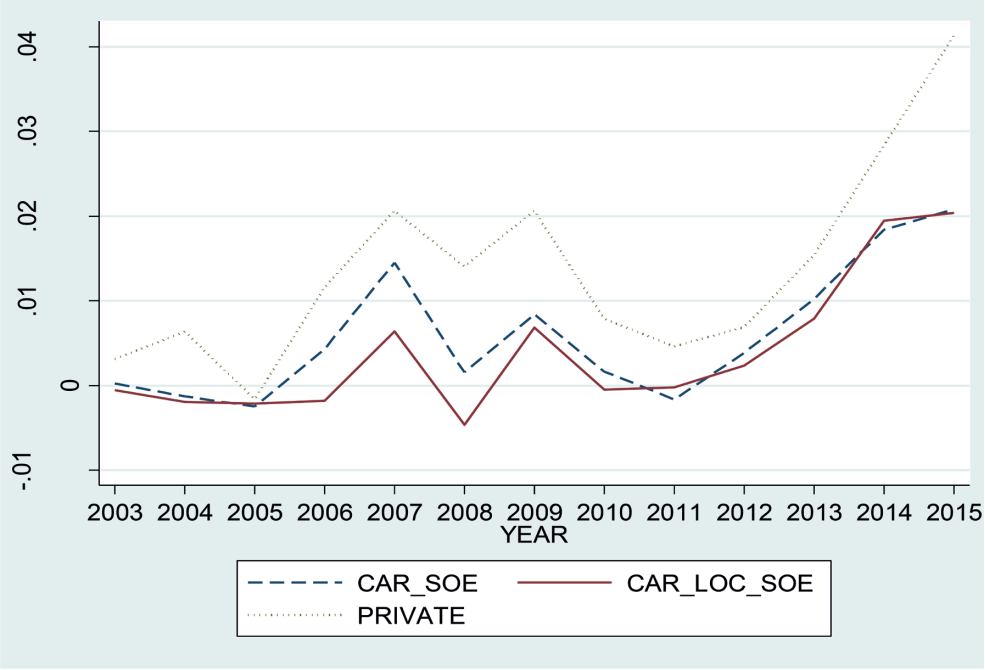
To measure the levels of political embeddedness, we create two dummies that refer to the local level of embeddedness. The dummy *locgov* takes the value 1 if the de facto owner of a firm is the local government and 0 otherwise. The dummy *locpc* takes the value 1 if a firm is identified as being politically connected with the local government, or local NPC or CPPCC and 0 otherwise.

4.3.3 M&A success

The success of M&A activities is multi-faceted regarding different stakeholders, periods, and firms' financial and non-financial performances (Zollo and Meier, 2008).

We focus on shareholders' interests and use both market-based and accounting-based measures of M&A success. For market-based measures, we adopt an event study methodology and calculate cumulative abnormal returns (CARs) based on the following three models: (1) Following Brown and Warner (1985), we use the CAPM and calculate CARs with a 90-day period transaction window, 30 days before the announcement date. (2) Following Dong et al. (2006), Fuller et al. (2002) and Kling and Weitzel (2011), we estimate a modified market adjusted model and compute CARs for the three-day period around the announcement date [-1, +1]. (3) Following Brown and Warner (1980, 1985), we compute CARs with a constant mean return model. Then, we calculate average CARs labeled *car* based on the three approaches.[20]

For accounting measures, in line with Kling et al. (2014), we focus on value creation and operational risk exposure of acquirers after M&A. Value creation is measured by the market-to-book ratio (*mtb*) and operational risk exposure is computed as the volatility of cash flows (*risk*).



Notes: The sub-group SOE indicates government-owned firms; The sub-group LOC_SOE indicates local government-owned firms; The sub-group PRIVATE indicates non-government-owned firms. The data contained in this Figure are calculated based on the data from the SDC database and the CSMAR database.

Figure 4.1: Comparison of CARs over time among subgroups with different types of ownership

20 Unfortunately, due to copyright issues, the calculated values of cumulative abnormal returns (CARs) of each firm-year observation cannot be shared. However, all transformed data and computations used for the analyses are available on request by the authors.

4.3.4 Deal-related variables

We use both a dummy (*crossborder*) and the deal volume (*volcrossborder*) to capture cross-border M&As. In line with the M&A literature (Erel et al., 2012; Fuller et al., 2002; Moeller et al., 2004; Rossi and Volpin, 2004; Weitzel and Berns, 2006), we control for several transaction-specific variables. The method of payment can influence the success of M&A, for cash mergers are regarded as positive signals (Tichy, 2001). Therefore, we indicate whether a transaction has been primarily a cash merger defined as 90% cash offer compared to the total offer price (*cashmerger*). Moreover, we distinguish between mergers and divestiture (*divestiture*). Finally, we account for whether the attitude of the acquirer is friendly (*attitude*), whether the target firm is publicly traded (*tglist*), whether the transaction is horizontal or vertical (*horizontal*) based on the four-digit SIC codes of acquirers and targets, and the status of completion (*completion*), which is a dummy.

4.3.5 Firm-specific variables

We account for firm-specific characteristics, financial conditions and corporate governance variables as these reflect firm resources (Kling and Weitzel, 2011, p.361). Firm-specific characteristics include firm size (*size*), duration from IPO to the sample year (*age*), and an indicator variable for the stock exchanges (*exchange*). Financial variables include return on assets (*roa*), financial leverage (*lev*), assets growth (*growth*) and free cash flow rate (*fcfrate*). Corporate governance-related variables include the proportion of independent directors (*independent*), managerial stock ownership (*mgtshare*), the Herfindahl-Hirschman Index of the first ten shareholdings (*hhi10*), board size (*board*), a duality dummy (if the chairman and CEO are the same person) (*duality*) and an international shareholding dummy (*intershare*). Table 4.1 shows definitions of all variables.

4.3.6 Methods

To test how different types and levels of political embeddedness affect firms' propensity for conducting cross-border M&As, i.e. our hypotheses H1 and H3, we employ both a dummy (*crossborder*) indicating whether firm i engages in cross-border M&As in year t and the deal volume (*volcrossborder*) as dependent variables. Accordingly, we apply both logistic models for our binary dependent variable (Equation 1) and random effect models to explain deal volume (Equation 2), which take the following forms:

$$crossborder_{\mathrm{it}} = \alpha + \sum_{j=1}^{15} \beta_j D_j + \sum_{k=1}^{5} \gamma_k D_k + \delta_1 gov_{it-1} + \delta_2 locgov_{it-1} + \delta_3 pc_{it-1} + \delta_4 locpc_{it-1} + \theta_1 size_{it-1} + \theta_2 lev_{it-1} + \theta_3 roa_{it-1} + \theta_4 fcfrate_{it-1} + \theta_5 growth_{it-1} + \theta_6 age_{it-1} + \theta_7 mgtshare_{it-1} + \theta_8 hhi10_{it-1} + \theta_9 independent_{it-1} + \theta_{10} board_{it-1} + \theta_{11} duality_{it-1} + \theta_{12} intershare_{it-1} + \varepsilon_{it} \quad (1)$$

$$volcrossborder_{it} = \alpha + \sum_{j=1}^{15} \beta_j D_j + \sum_{k=1}^{5} \gamma_k D_k + \delta_1 gov_{it-1} + \delta_2 locgov_{it-1} + \delta_3 pc_{it-1} + \delta_4 locpc_{it-1} + \theta_1 size_{it-1} + \theta_2 lev_{it-1} + \theta_3 roa_{it-1} + \theta_4 fcfrate_{it-1} + \theta_5 growth_{it-1} + \theta_6 age_{it-1} + \theta_7 mgtshare_{it-1} + \theta_8 hhi10_{it-1} + \theta_9 independent_{it-1} + \theta_{10} board_{it-1} + \theta_{11} duality_{it-1} + \theta_{12} intershare_{it-1} + \varepsilon_{it} + u_i \quad (2)$$

In equation (1) and (2), political embeddedness is included as either *gov* and *pc* or *locgov* and *locpc* to capture different levels of political ties. Besides, we account for firm-specific control variables, and include year-dummies (*year*) to control for omitted variables that vary over time but are constant among the firms, and industry-dummies (*industry*) to control for industry-specific effects.

To test H2 and H4, which expect that PEEs, especially local PEEs would benefit less from M&A activities, we need to explain the success of M&A, which includes domestic and cross-border transactions. The specification of the model is similar to Equation (1), except that the dependent variables are the equally weighted cumulative abnormal return (*car*), market-to-book ratio (*mtb*) and operational risk (*risk*), and that control variables include deal-related indicators. We estimate the following model specification with random effects for the three measures of value creation. Additionally, to test the effect on CAR, we also use quantile regressions analysis as CARs tend to exhibit outliers. In all the analyses, the explanatory variables are lagged by one year to account for alleged endogeneity. Using lagged variables ensures weak exogeneity.[21]

21 To address the fact that the influence of government ownership on firms' internationalization strategies and M&A success may differ depending on the presence of political connections and vice versa, we also estimated models including both the direct effects of government ownership and political connections and their interaction. However, the results of the additional tests (reported in Table C.1) did not show significant interaction effects, indicating no combined effects of government ownership and political connections on firms' internationalization strategies and M&A success for the Chinese listed firms. These findings suggest that the effects of the two dimensions of political embeddedness on firms' M&A practices do not reinforce each other.

$$M\&A\_performance_{it} = \alpha + \sum_{j=1}^{15} \beta_j D_j + \sum_{k=1}^{5} \gamma_k D_k + \delta_1 gov_{it-1} + \delta_2 locgov_{it-1} + \delta_3 pc_{it-1} + \delta_4 locpc_{it-1} + \theta_1 size_{it-1} + \theta_2 lev_{it-1} + \theta_3 roa_{it-1} + \theta_4 fcfrate_{it-1} + \theta_5 growth_{it-1} + \theta_6 age_{it-1} + \theta_7 mgtshare_{it-1} + \theta_8 hhi10_{it-1} + \theta_9 independent_{it-1} + \theta_{10} board_{it-1} + \theta_{11} duality_{it-1} + \theta_{12} intershare_{it-1} + \vartheta_1 completion_{it} + \vartheta_2 attitude_{it} + \vartheta_3 divestiture_{it} + \vartheta_4 cashmerger_{it} + \vartheta_5 tglist_{it} + \vartheta_6 horizontal_{it} + \varepsilon_{it} + u_i \quad (3)$$

In addition, the assumptions underlying the regressions were tested for multicollinearity based on the pairwise correlation matrix and the variance inflation factors. All variance inflation factors (VIF) are less than 2, which shows that multicollinearity is not present. In addition, in an analysis on residuals, normality and homoscedasticity were not rejected.

Table 4.2: M&A activity, deal structure and success

Year	Cross-border	Domewstic	Total	Cash mergers percent	State-led M&A percent	Deal volume ($Mil)	Volume per deal ($Mil)	Car	Value weighted car	MTB	Risk
2000	1	23	24	83.33%	-	471.9	19.663	2.63%	2.97%	3.235	2.246
2001	0	25	25	80.00%	-	2875	115.000	0.23%	0.78%	2.487	2.453
2002	3	97	100	57.89%	-	2938	29.380	0.44%	1.02%	1.892	2.516
2003	5	212	217	70.77%	62.21%	4318	19.899	0.09%	0.88%	1.440	2.289
2004	1	301	302	71.90%	56.29%	3913	12.957	0.05%	-0.18%	1.115	2.246
2005	3	195	198	83.08%	58.08%	1857	9.379	0.18%	0.24%	0.883	2.246
2006	1	215	216	57.69%	45.83%	9491	43.940	1.71%	4.71%	1.302	2.246
2007	12	371	383	52.48%	49.87%	25396	66.308	3.04%	6.91%	2.847	3.977
2008	10	471	481	46.43%	50.10%	58878	122.407	1.46%	-2.15%	1.225	3.356
2009	11	414	425	50.75%	52.00%	40623	95.584	3.15%	10.60%	2.457	3.674
2010	21	545	566	66.28%	47.53%	67829	119.839	1.90%	7.91%	2.567	3.125
2011	30	655	685	76.95%	41.75%	46744	68.239	0.89%	1.81%	1.648	2.999
2012	29	652	681	70.59%	36.42%	41836	61.433	1.47%	4.72%	1.536	2.820
2013	32	736	768	59.44%	32.68%	90437	117.757	3.23%	6.50%	1.759	3.016
2014	29	862	891	49.47%	29.52%	140448	157.630	5.28%	12.56%	2.108	3.398
2015	62	1,140	1,202	17.15%	23.46%	291512	242.522	5.37%	5.62%	3.087	3.554
Total	250	6,914	7,164	48.52%	38.68%	829566.9	115.797	1.94%	4.06%	1.974	2.885

Notes: State-led M&A percentages from 2000 to 2002 are not presented due to a data default.

4.4 Results

4.4.1 Descriptive analysis

Usually there is only one bidder, except in one case with two bidders and two cases with three. There are no hostile M&As in our sample, with 86% friendly and 14% neutral. Moreover, only 45.3% of the bids have been completed. Among those not completed, 48.7% are still pending and 6% were withdrawn. Table 4.2 presents descriptive statistics for our sample highlighting the number and types of transactions, method of payment, state involvement, deal volumes, and measures of success.

In the 16-year sample period, the number of Chinese M&A transactions has ascended dramatically by 4,908%. Except for a sharp decline in 2005 and modest slowdowns in 2009 and 2012, Chinese firms conduct M&A activities on a steadily rising pace until 2015. However, cross-border deals account for only 5.16% among all M&A transactions. Nevertheless, the tendency to internationalize has increased, especially with 2007 witnessing a pronounced upturn and in 2015 cases doubled compared to the previous year reaching a peak. Together with the increasing number of transactions deal volumes have surged, although the increase in volume per deal has been less pronounced. In contrast to earlier studies (Kling and Weitzel, 2011), cash is no longer the predominant method of payment with less than half (48.52%) of all transactions making room for other forms of payment such as stocks and assets.

The involvement of the government in M&A activities has declined from 62.21% in 2003 to 23.46% in 2015, meaning that with the deepening of economic reformations, government intervention in the economy has reduced. 2015 seems to be an exceptional year as compared to 2014, the number of cross-border M&As doubled and domestic deals also increased considerably. Deal volumes in 2015 also doubled, and the volume per deal reached its peak. Moreover, cash payments and government involvement reached their lowest levels. These phenomena could be explained by two major policy changes concerning M&As and OFDI around 2015. First, the Chinese State Council has issued *The Opinions on Further Optimizing the Market for Mergers and Restructuring* in March 2014, which was followed by the CSRC's revision of *The Regulations for Major Assets Restructuring of Listed Companies* and *The Regulations for Mergers and Acquisitions of Listed Companies* in July 2014. These new regulations have facilitated M&As due to improved administrative processes, transaction mechanisms, financial support and payment methods. Especially in January 2015, new accounting and taxation policies regarding M&A activities issued by both the Ministry of Finance and the State Administration of Taxation of China have made other means of financing easier. Second, *The Vision and Action of the Belt and Road* co-issued by the National Development and Reform Commission, the Ministry of Foreign Affairs and the Ministry of Commerce of China in March 2015 and its following relevant policies have stimulated Chinese OFDI.

M&As were rather successful indicated by positive average CARs and MTB in excess of one (Kling et al., 2014). In contrast to Kling and Weitzel (2011) is that value weighted CARs (4.06%) are higher than equally weighted measures (1.94%) for all the firms, indicating that larger deals are more successful. These discrepancies are partly due to excluding the Hong Kong Stock Exchange from our sample and a more up-to-date investigation period. In addition, as is shown in Figure 4.1, we compare CARs with sub-samples based on government ownership. The M&As of non-SOEs are the most successful and all the means of CARs are above zero throughout the sample period. By contrast, the M&As of SOEs are less successful, with four years exhibiting negative average CARs. The fact that SOEs' M&As underperform non-SOEs' is mainly caused by low performance of local SOEs.

Table 4.3 reports political embeddedness indicators of acquiring firms from 2000 to 2015. While the proportion of central SOEs has risen steadily, the number of SOEs has followed a downward trend. This is a result of privatization in recent years, particularly among local SOEs. By contrast, the number of politically connected executives, especially the ones with local political connections increased.[22] Table 4.4 reports summary statistics for the dependent, independent and control variables employed in our analyses.

Table 4.3: Political embeddedness and corporate governance

Year	Gov	Central Gov	Pc	Central Pc	Mgt-share	HHI	Independent	Board	Duality	B-share	H-share
2000	-	-	0.527	0.177	-	-	0.017	9.420	0.152	-	-
2001	-	-	0.590	0.150	-	-	0.063	9.372	0.115	-	-
2002	-	-	0.751	0.117	-	-	0.241	9.861	0.129	-	-
2003	0.600	0.236	0.802	0.133	0.000	0.232	0.328	9.858	0.156	0.061	0.016
2004	0.604	0.257	0.823	0.099	0.000	0.226	0.342	9.703	0.153	0.057	0.016
2005	0.609	0.270	0.824	0.106	0.000	0.212	0.348	9.566	0.130	0.057	0.015
2006	0.584	0.294	0.839	0.113	0.002	0.175	0.352	9.429	0.136	0.051	0.018
2007	0.561	0.303	0.847	0.095	0.004	0.172	0.359	9.394	0.151	0.043	0.021
2008	0.554	0.326	0.858	0.099	0.011	0.175	0.362	9.262	0.155	0.040	0.020
2009	0.525	0.336	0.849	0.094	0.037	0.175	0.365	9.151	0.186	0.031	0.017
2010	0.457	0.346	0.846	0.103	0.081	0.177	0.367	9.078	0.220	0.025	0.012
2011	0.416	0.348	0.842	0.096	0.103	0.177	0.369	8.988	0.246	0.021	0.011
2012	0.398	0.343	0.833	0.087	0.109	0.179	0.370	8.973	0.251	0.020	0.012
2013	0.395	0.339	0.836	0.082	0.103	0.175	0.374	8.858	0.249	0.019	0.011
2014	0.377	0.339	0.827	0.078	0.095	0.168	0.373	8.696	0.259	0.017	0.010
2015	0.350	0.348	0.711	0.066	0.098	0.161	0.377	8.584	0.266	0.015	0.009
Total	0.469	0.314	0.799	0.106	0.062	0.181	0.333	9.154	0.215	0.031	0.014

Notes: The averages of government-owned firms, central government-owned firms, management shareholding, ownership concentration, B-share firms and H-share firms from 2000 to 2002 are not presented due to a data default.

22 To make it comparable with Kling and Weitzel (2011), we also include corporate governance measures of acquiring firms in Table 4.3. Please refer to Page 362-364 of Kling and Weitzel (2011).

Table 4.4: Summary statistics

Variable	Obs	Mean	Std.Dev.	Min	Max
car	6,127	0.027	0.074	-0.083	0.202
mtb	29,199	1.995	1.525	0.354	5.973
risk	20,886	3.283	0.517	2.246	4.346
crossborder	7,164	0.035	0.184	0.000	1.000
volcrossborder	7,164	0.112	0.713	-3.101	8.869
gov	25,466	0.469	0.499	0.000	1.000
locgov	25,466	0.320	0.467	0.000	1.000
pc	28,894	0.799	0.401	0.000	1.000
locpc	28,894	0.721	0.449	0.000	1.000
size	30,311	21.595	1.153	19.811	24.126
lev	30,311	0.471	0.209	0.115	0.855
roa	28,948	0.035	0.047	-0.083	0.124
fcfrate	26,729	0.002	0.095	-0.235	0.160
growth	28,946	0.182	0.281	-0.163	0.992
age	30,314	12.325	5.556	0.000	35.000
mgtshare	25,461	0.062	0.152	0.000	0.891
hhi10	25,466	0.181	0.127	0.000	0.810
independent	28,725	0.333	0.107	0.000	0.800
board	28,730	9.155	2.076	0.000	22.000
duality	23,365	0.215	0.410	0.000	1.000
intershare	30,314	0.136	0.343	0.000	1.000
completion	7,164	0.453	0.498	0.000	1.000
attitude	7,164	0.860	0.347	0.000	1.000
divestiture	7,164	0.386	0.487	0.000	1.000
cashmerger	7,164	0.255	0.436	0.000	1.000
tglist	7,164	0.025	0.156	0.000	1.000
horizontal	7,164	0.239	0.427	0.000	1.000

Notes: See Table 4.1 for variable definitions.

4.4.2 Political embeddedness and propensity for conducting cross-border M&As

Table 5 reports the results of different model specifications of Equation (1) and (2) for the hypothesized relationship between political embeddedness and the propensity for conducting cross-border M&As in China. The model specifications A and B are the results of logit regression with the dummy *crossborder* as the dependent variable. Specifications C and D use transaction volume of cross-border deals (*volcrossborder*) as the dependent variable estimated with a random effects model. Models A and C focus on the influence of different types of political embeddedness on the likelihood to conduct cross-border M&As showing a negative and significant impact of government ownership after controlling for firm-specific variables and corporate governance measures. Political connections, however, have a negative yet insignificant impact on both the *crossborder* dummy and deal volume. Together,

these findings confirm H1, indicating that PEEs, especially SOEs are more likely to conduct cross-border M&As than NPEEs in China. Furthermore, we consider different levels of political embeddedness and use two dummies *locgov* and *locpc* to compare the influence of the local level with the central level. As shown in specifications B and D, local SOEs are less likely to conduct cross-border M&As than central ones, given both the number of transactions and volumes. In summary, the findings in Models B and D provide support for H3 indicating that compared with local PEEs, central PEEs are more likely to conduct cross-border M&As.

4.4.3 Political embeddedness and M&A success

Table 4.6 and 4.7 present the results of different model specifications of Equation (3) for the hypothesized relationship between political embeddedness and M&A success. Table 4.6 reports the results of both random effects (Models E and F) and quantile regressions (Models G and H) for CARs (*car*). Models E and G show negative yet not significant partial impacts of political embeddedness on CARs indicating that in China, there is not much difference between PEEs and NPEEs regarding M&A short-term success. This finding is consistent with that of Kling and Weitzel (2011, p.369). However, the findings of Models F and H show that the level of government ownership does make a difference in influencing firms' CARs. The negative and significant relation between *locgov* dummy and *car* means that in China, local SOEs are more likely to have lower CARs than central SOEs in M&A activities.

Table 4.7 reports the results of random effects for *mtb* and *risk*. As is shown by Model I and K, SOEs benefit less from M&A activities as they tend to have lower MTBs and higher operational risks than non-SOEs one year after M&A announcements. Model J and L show evidence for the hypothesis that the level of political embeddedness does influence M&A success. Clearly, local SOEs are more likely to have lower MTBs and higher operational risks than their central peers. Local political connection also reduces firms' MTB after M&A, but does not affect operational risks. In summary, our findings in Table 4.6 and 4.7 provide partial support for H2 by indicating that only government ownership reduces acquirers' M&A success. Moreover, H4 is also confirmed, for both measures of political embeddedness show negative effects for local levels.

Table 4.5: Effects of political embeddedness on cross-border mergers (dependent: A/B: crossborder; C/D: volcrossborder)

	[A]	[B]	[C]	[D]
L.gov	-0.431**		-0.054**	
	(-2.32)		(-1.98)	
L.pc	-0.134		-0.022	
	(-0.69)		(-0.76)	
L.locgov		-0.748***		-0.104***
		(-3.71)		(-3.85)
L.locpc		-0.176		-0.025
		(-1.08)		(-1.06)
L.size	0.473***	0.479***	0.062***	0.063***
	(4.99)	(5.09)	(4.60)	(4.77)
L.lev	-1.252**	-1.327***	-0.125*	-0.128*
	(-2.47)	(-2.62)	(-1.82)	(-1.89)
L.roa	2.501	2.279	0.182	0.155
	(1.19)	(1.09)	(0.67)	(0.57)
L.fcfrate	0.202	0.264	-0.007	0.001
	(0.24)	(0.31)	(-0.07)	(0.01)
L.growth	0.180	0.199	-0.017	-0.016
	(0.54)	(0.61)	(-0.38)	(-0.35)
L.age	-0.011	-0.005	0.001	0.002
	(-0.61)	(-0.29)	(0.44)	(0.68)
L.mgtshare	-0.471	-0.461	-0.067	-0.070
	(-0.82)	(-0.81)	(-0.78)	(-0.81)
L.hhi10	0.050	0.009	0.113	0.119
	(0.08)	(0.01)	(1.15)	(1.22)
L.independent	-2.565*	-2.619*	-0.447**	-0.450**
	(-1.65)	(-1.69)	(-2.13)	(-2.15)
L.board	-0.009	-0.005	0.001	0.002
	(-0.19)	(-0.10)	(0.14)	(0.22)
L.duality	0.177	0.187	0.015	0.015
	(1.00)	(1.05)	(0.56)	(0.55)
L.intershare	0.373	0.331	0.145**	0.140**
	(1.21)	(1.07)	(2.46)	(2.39)
Industry dummies	Y	Y	Y	Y
Year dummies	Y	Y	Y	Y
Random province effects	Y	Y	Y	Y
Random firm effects	Y	Y	Y	Y
Intercept	-10.466***	-10.776***	-0.483	-0.522
	(-4.71)	(-4.85)	(-1.37)	(-1.49)
N	5482	5482	5576	5576
Wald chi2	81.667	92.410	106.762	118.910

Notes: ***, ** and * indicate statistical significance at 1 %, 5 %, and 10 % levels respectively (two-tailed), z-values are below the regression coefficients in parentheses. Individual coefficients of the industry dummies, year dummies, and random province and firm effects are not reported for parsimony. See Table 4.1 for variable definitions.

Table 4.6: Effects of political embeddedness on M&A success
(Dependent: car)

	[E]	[F]	[G]	[H]
L_gov	-0.004		-0.007	
	(-1.45)		(-1.45)	
L_pc	-0.001		-0.002	
	(-0.23)		(-0.46)	
L_locgov		-0.007**		-0.011**
		(-2.36)		(-2.41)
L_locpc		0.001		0.001
		(0.30)		(0.28)
L_size	-0.014***	-0.013***	-0.021***	-0.021***
	(-8.91)	(-9.00)	(-8.49)	(-8.50)
L_lev	0.025***	0.025***	0.036***	0.033**
	(3.24)	(3.20)	(2.74)	(2.55)
L_roa	-0.167***	-0.168***	-0.215***	-0.210***
	(-5.38)	(-5.42)	(-4.01)	(-3.93)
L_fcfrate	-0.003	-0.002	-0.008	-0.012
	(-0.23)	(-0.18)	(-0.36)	(-0.56)
L_growth	0.005	0.005	0.005	0.004
	(1.01)	(1.05)	(0.54)	(0.45)
L_age	0.001**	0.001**	0.000	0.000
	(2.28)	(2.43)	(0.89)	(0.86)
L_mgtshare	0.003	0.003	0.006	0.006
	(0.33)	(0.35)	(0.40)	(0.38)
L_hhi10	0.024**	0.024**	0.037**	0.040**
	(2.25)	(2.26)	(2.17)	(2.36)
L_independent	0.017	0.016	0.020	0.011
	(0.75)	(0.70)	(0.53)	(0.29)
L_board	0.000	0.000	-0.000	-0.000
	(0.29)	(0.28)	(-0.25)	(-0.32)
L_duality	-0.001	-0.001	-0.003	-0.001
	(-0.46)	(-0.42)	(-0.69)	(-0.15)
L_intershare	-0.004	-0.004	0.002	-0.002
	(-0.65)	(-0.71)	(0.21)	(-0.21)
completion	0.019***	0.019***	0.035***	0.033***
	(8.77)	(8.76)	(8.86)	(8.33)
attitude	0.002	0.002	0.002	0.003
	(0.68)	(0.65)	(0.28)	(0.47)
divestiture	0.004*	0.004*	0.008*	0.008**
	(1.82)	(1.84)	(1.86)	(2.04)
cashmerger	-0.011***	-0.011***	-0.015***	-0.013***
	(-4.67)	(-4.65)	(-3.39)	(-3.05)
tglist	0.025***	0.025***	0.042***	0.038***
	(3.41)	(3.41)	(3.21)	(2.92)
horizontal	-0.003	-0.003	-0.002	-0.002
	(-1.10)	(-1.11)	(-0.44)	(-0.48)

Table 4.6: Continuation

	[E]	[F]	[G]	[H]
Industry dummies	Y	Y	Y	Y
Year dummies	Y	Y	Y	Y
Random province effects	Y	Y	Y	Y
Random firm effects	Y	Y	Y	Y
Intercept	0.208***	0.206***	0.362***	0.358***
	(5.34)	(5.31)	(5.60)	(5.57)
N	4883	4883	4883	4883
Wald chi2	613.371	617.678		

Notes: ***, ** and * indicate statistical significance at 1 %, 5 % and 10 % levels respectively (two tailed); z-values (for random effect models and logistic models) and t-values (for quantile regressions) are below the regression coefficients in parentheses. Individual coefficients of the industry dummies, year dummies, and random province and firm effects are not reported for parsimony. See Table 4.1 for variable definitions.

Table 4.7: Effects of political embeddedness on valuation and risk (Dependent: I/J: mtb; K/L: risk)

	[I]	[J]	[K]	[L]
L.gov	-0.166***		0.015*	
	(-3.65)		(1.90)	
L.pc	-0.036		0.009	
	(-0.84)		(1.09)	
L.locgov		-0.284***		0.014*
		(-6.28)		(1.76)
L.locpc		-0.061*		-0.002
		(-1.72)		(-0.31)
L.size	-0.805***	-0.802***	-0.000	0.001
	(-35.67)	(-35.95)	(-0.04)	(0.18)
L.lev	-0.671***	-0.682***	-0.003	-0.003
	(-6.22)	(-6.34)	(-0.13)	(-0.12)
L.roa	3.562***	3.542***	-0.084	-0.088
	(8.99)	(8.96)	(-0.97)	(-1.02)
L.fcfrate	0.013	0.030	0.013	0.012
	(0.09)	(0.20)	(0.37)	(0.32)
L.growth	0.180***	0.186***	0.038**	0.037**
	(2.87)	(2.98)	(2.52)	(2.44)
L.age	0.003	0.005	0.001	0.001
	(0.52)	(0.89)	(0.94)	(0.80)
L.mgtshare	-0.247*	-0.242*	0.032	0.029
	(-1.72)	(-1.70)	(1.22)	(1.12)
L.hhi10	0.561***	0.570***	0.001	0.004
	(3.46)	(3.55)	(0.03)	(0.13)

Table 4.7: Continuation

	[I]	[J]	[K]	[L]
L.independent	0.934***	0.944***	-0.054	-0.047
	(2.96)	(3.00)	(-0.83)	(-0.72)
L.board	0.016	0.017	0.001	0.001
	(1.47)	(1.60)	(0.24)	(0.48)
L.duality	0.075*	0.077*	-0.005	-0.006
	(1.84)	(1.91)	(-0.59)	(-0.74)
L.intershare	0.261**	0.249**	-0.009	-0.008
	(2.38)	(2.29)	(-0.56)	(-0.49)
completion	0.020	0.020	0.002	0.002
	(0.75)	(0.75)	(0.30)	(0.30)
attitude	-0.000	-0.004	0.002	0.002
	(-0.01)	(-0.10)	(0.18)	(0.21)
divestiture	-0.005	-0.004	-0.001	-0.001
	(-0.18)	(-0.15)	(-0.21)	(-0.19)
cashmerger	-0.074**	-0.072**	0.005	0.004
	(-2.43)	(-2.37)	(0.63)	(0.59)
tglist	0.095	0.090	0.024	0.024
	(1.12)	(1.07)	(1.15)	(1.12)
horizontal	-0.061*	-0.062*	-0.000	0.000
	(-1.86)	(-1.88)	(-0.00)	(0.02)
Industry dummies	Y	Y	Y	Y
Year dummies	Y	Y	Y	Y
Random province effects	Y	Y	Y	Y
Random firm effects	Y	Y	Y	Y
Intercept	17.893***	17.792***	0.944***	0.939***
	(30.73)	(30.74)	(3.76)	(3.74)
N	5347	5347	5277	5277
Wald chi2	5419.721	5487.051	18018.692	18010.723

Notes: ***, ** and * indicate statistical significance at 1 %, 5 % and 10 % levels respectively (two tailed); z-values are below the regression coefficients in parentheses. Individual coefficients of the industry dummies, year dummies, and random province and firm effects are not reported for parsimony. See Table 4.1 for variable definitions.

4.5 Discussion and conclusion

This study investigates how political embeddedness affects Chinese listed firms' propensity for conducting cross-border M&As and M&A success. Theoretically, we argue that compared with NPEEs, PEEs are less likely to conduct cross-border M&As due to institutional resistance from both home and host country. In addition, PEEs tend to benefit less from M&A activities because of multiple and conflicting goals. By using both government ownership and political connections as proxies for

political embeddedness, our results show that government ownership is the major channel through which the government influences cross-border activities and M&A success. We find that compared to non-SOEs, SOEs conduct significantly less cross-border M&As. This finding is consistent with Cui and Jiang (2009) and Kling and Weitzel (2011). In addition, our findings confirm the theoretical expectation that SOEs benefit less from M&A activities by indicating that SOEs exhibit lower MTBs and higher operational risks after M&A activity than non-SOEs, although we do not find significant evidence for the relation between government ownership and CARs.

Given the assertion that the level of political embeddedness matters in firms' inclination of going global, we find evidence for the hypothesis that central SOEs are more likely to conduct cross-border M&As than local SOEs. Our findings also indicate that central SOEs benefit more than local SOEs, in terms of CARs, MTBs and operational risks. This finding indicates that local SOEs exhibit poor M&A performance, which is in line with Xia and Fang (2005, p.50) who contend that "the value-destroying effect of SOEs is mainly caused by local SOEs".

By contrast, as another measure of political embeddedness, executives' political connections do not have a strong influence on firms' propensity for conducting cross-border M&As and M&A success. Given the insignificant effect of political connections on the propensity for conducting cross-border M&As, politically connected firms could have encountered less resistance than theoretically expected, concerning both environments of home and host country. On the home country's side, unlike SOEs, politically connected firms could be confronted with less scrutiny for OFDI in key industries, because political connections depend less on industries. On the host country's side, firms with political connections might also have less resistance because unlike state ownership, ties between executives and home country's political entities might cause far less concerns, or might even remain unnoticed. The insignificant effect of political connections on M&A success could possibly be explained by the fact that the goal divergence between firms and politically connected executives is much smaller than that in SOEs. First, as mentioned above, politically-driven M&As are mostly done due to political pressure from the government ownership. Second, different from that in SOEs, the personal goals of politically connected managers are more self-serving. Since their political and personal career are closely related with corporate performance, connected managers would consider value creation when selecting M&A projects.

These findings have several important implications for managerial practice and research related to cross-border M&As. First, the findings are likely to be helpful for investors and other stakeholders in assessing the likelihood of conducting cross-border M&As and M&A success of Chinese listed firms. Second, the finding that different forms and levels of political embeddedness, i.e. government ownership

and political connections on central and local levels, have different effects on firms' internationalization behavior and M&A success has important implications for decision makers. Third, our finding that the negative effect of local government on firms' propensity for conducting cross-border M&As and M&A success is much stronger than that of central government has practical implications. This finding optimizes the orientation of reformation for policy makers of developing countries like China by rectifying the general practice that all kinds of government ownership are treated uniformly and suggesting that the national governance in emerging economies should focus on the reformation of local government.

Our limitation lies in the proxies of political embeddedness. The underlying assumption is that all politically embedded firms have similar extents of connections. However, the degree of political influence might differ among firms, most of which is challenging to quantify. Moreover, the influence from political connections should be expected to differ for a member of parliament or a minister in the government. Consequently, different types of political connections, besides the differentiation of local or central connections, may have different effects. Regarding the proxies of M&A success, we only considered short-term measures, thus neglecting the long-term effects. Based on these findings and limitations, future research could provide a more detailed measurement of the degree of political influence. Overall, more research is needed to improve our understanding of the influence of political embeddedness on firms' strategic decision making.

CSR
МФА

Chapter 5

Conclusion

5.1 Summary

The central theme of this dissertation is the influence of political embeddedness on corporate reporting and internationalization strategies in China. I choose the Chinese market because it provides a typical institutional setting where the government has considerable control over the micro-economy and could thus draw a profound influence on corporate affairs. Instead of focusing exclusively on either government ownership or political connections, this dissertation takes a broader approach to government intervention on corporate affairs by addressing both dimensions separately as well as together.[23] In addition, given that different objectives of different levels of government might lead to different impacts on corporate affairs, this dissertation provides a more advanced measurement of political embeddedness by differentiating between local and central levels of government. In terms of corporate strategies, this dissertation focuses on corporate financial and non-financial reporting and internationalization, more specifically, on the effect of political embeddedness on earnings management, CSR practices, and cross-border M&As. These three areas are particularly interesting to study because they have all been recently subject to considerable policy changes in China.

Chapter 2 investigates how political embeddedness influences the listed Chinese firms' choices for earnings management strategies. By using government ownership and political connections as measures of political embeddedness and multiple proxies for real and accrual-based earnings management, the results indicate that government-owned firms, especially central government-owned firms, are more likely than non-government-owned firms to substitute real earnings management for accrual-based earnings management. Regarding political connections, the results also indicate that firms with political connections are more likely to resort to real earnings management strategies and to use more accrual-based earnings management than their non-connected peers. However, since the relative increase in the use of real earnings management is greater than that of accrual-based earnings management, there is a relative substitution effect for politically connected firms. The results additionally indicate that there is no significantly different substitution effect between the firms with central political connections and the ones with local political connections. This chapter finds that government ownership and political connections play considerable, albeit different, roles in explaining the variance in firms' choices for earnings management strategies in China.

23 To address the fact that the influence of government ownership on firms' reporting and internationalization strategies may differ depending on the presence of political connections and vice versa, I also estimated models including both the direct effects of government ownership and political connections and their interaction. However, the interaction effects were not statistically significant, suggesting that the effects of the two dimensions of political embeddedness on corporate reporting and internationalization strategies do not reinforce each other.

Chapter 3 examines whether and how political embeddedness influences the diffusion of CSR practices in China. It investigates how government ownership and political connections affect the listed Chinese firms' likelihood of issuing CSR reports, their underlying CSRP, and its relationship with the firms' CFP. The results indicate that politically embedded firms, including both government-owned and politically connected firms and central politically embedded firms in particular, are more likely to issue CSR reports than non-politically embedded firms. The results also indicate that politically embedded firms have a higher average CSRP than non-politically-embedded firms. In addition, the CSRP of central politically connected firms is higher than that of local politically connected firms. This chapter shows that, in China, the government can shape firms' CSR practices significantly; they can do this directly through (majority) ownership and indirectly through politically connected executives.

Chapter 4 investigates how political embeddedness affects both the propensity of the listed Chinese firms for conducting cross-border M&As and the success of the M&As. The results show that government-owned firms conduct significantly less cross-border M&As than non-government-owned firms. Moreover, government-owned firms benefit less from M&A activities in comparison to non-government-owned firms. By contrast, as another measure of political embeddedness, the executives' political connections do not have a strong influence on a firm's propensity for conducting cross-border M&As or their M&A success. This chapter suggests that government ownership is the major channel through which the government influences firms' cross-border activities and M&A success in China.

5.2 Limitations

Since all three studies in this dissertation deal with political embeddedness, the limitations of the proxy for political embeddedness apply to them all. One of the contributions of this dissertation is that it provides a better approach when measuring political embeddedness by considering both the direct channel (i.e., government ownership) and the indirect channel (i.e., political connections) through which the government exerts influences on corporate financial strategies. However, a limitation of the proxy for political embeddedness still lies in the fact that, in this dissertation, I only apply dummies as proxies for government ownership, political connections, and their levels. Since only using dummies cannot distinguish the magnitude of political embeddedness in a continuous manner, it is not conducive to capturing the influence of political embeddedness accurately.

In addition, some limitations of the proxy of political embeddedness lie in the definitions of government ownership and political connections. In the dataset

adopted in this dissertation, a firm is defined as government-owned if its largest de facto shareholder is the government. This neglects the potential influences from the government in the non-government-owned firms classified by this definition. For example, the cases where the government is the second largest shareholder are defined as non-government-owned. However, the government might still have interventional influences on firm affairs, which are neglected in this dissertation. For the definition of political connections, there is a distinction among the connections with the government, with the National People's Congress (NPC), and with the Chinese People's Political Consultative Conference (CPPCC). The connections with different authorities might possess different objectives, bring different resources, or draw different influential power. However, due to limited data accessibility, the three types of connections are treated unitarily in this dissertation.

I differentiated between central and local levels of political embeddedness based on the contention that different levels of political embeddedness possess different objectives and thus may have different influences on corporate affairs. However, the data did not allow for deeper scrutiny at the local levels. Just as at the central and local levels, the relationships among different levels of local political embeddedness (i.e., provincial, municipal, county, and rural) are also principal-agents in the Chinese political system. Specifically, the upper level of the government functions as a principal in regional affairs. Meanwhile, because the administrative rights of the lower level of government are authorized by its upper level peer, the lower level of the government is more an agent of its upper level peer (Xia and Fang, 2005). Therefore, taking the entirety of the local levels of political embeddedness together limits our understanding of the full depth and breadth of the relationship between political embeddedness and corporate strategies.

Further limitations lie in the proxies of corporate strategies. For example, in Chapter 2, although I included the concepts of both accrual-based and real earnings management, I only considered the levels of these earnings management strategies and thus neglected other aspects of earnings management, such as timeliness, value relevance, and earnings conservatism. While Chapter 3 considers the likelihood of firms issuing CSR reports, the CSRP, and the CSRP-CFP relationship, it does not examine the relationship between political embeddedness and other aspects of CSR, such as the credibility of the CSRP information displayed in the CSR reports. In addition, one of the contributions in Chapter 3 is that this research provides the first evidence of both the effectiveness of government-induced CSR policies in China and of the potential opportunity costs that the policies imply: the tradeoff with financial performance. However, the opportunity cost imposed on firms due to an improved CSP cannot necessarily be limited to only the financial impacts on the firms.

5.3 Suggestions for future research

Based on the above-mentioned limitations, several directions for future research can be identified. First, to provide a clearer picture of the mechanisms behind the effects of political embeddedness, further research is needed for a more detailed measurement of the degree of political influence on corporate strategies. To capture the degree of political embeddedness better, it would be useful to adopt continuous variables for proxies of government ownership and political connections. For example, instead of using a dummy, government ownership could be measured by the percentage of total shareholding by the government. In addition, from the perspective of corporate governance, ownership concentration, which might draw influence on the control power of the largest shareholder, could be considered in building a composite indicator of government control power, together with government shareholding. Future research could also differentiate government ownership and government involvement by considering the government's influence in cases where government shareholding exists yet not the largest.

Two improvements regarding the measure of political connections could be considered. As mentioned in the limitations, the types of political connections (i.e., connections with the government, the NPC, or the CPPCC) should be differentiated. In addition, the degree of political connections could be measured by the length of period that a politically connected manager has served in the political system, or by the managerial ranks in the company, as these factors might influence the power of the manager. The possible relationships or the affinity between the corporate managers and their networks in the political system might also be considered.

Drawing on the special institutional background and the political system of China, studies about political embeddedness in the Chinese setting should make a more detailed classification of the levels of political embeddedness. For instance, it might be interesting to investigate how the influences from the provincial, municipal, county, and rural levels of political embeddedness differ from each other and/or from the involvement by the central level. Overall, a more fine-tuned measurement of political embeddedness is required for a deeper understanding of the influence of political embeddedness on corporate strategies in China.

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Appendix A

Appendix to Chapter 2

Table A.1: Effects of political embeddedness on earnings management substitution (with interaction between GOV and PC)

	RM_CD/AM	RM_PD/AM	RM_CPD/AM
	Model 1	Model 2	Model 3
GOV	0.532*	0.949**	0.742**
	(1.80)	(2.11)	(2.24)
PC	0.593*	1.114**	0.758**
	(1.94)	(2.40)	(2.21)
GOV*PC	-0.100	-0.146	-0.116
	(-0.27)	(-0.26)	(-0.28)
SIZE	-0.265***	-0.453***	-0.318***
	(-3.86)	(-4.34)	(-4.12)
LEV	2.464***	3.792***	3.165***
	(5.51)	(5.58)	(6.31)
LIQ	0.044	-0.005	0.054
	(0.53)	(-0.04)	(0.59)
GO	0.020	0.042	0.074
	(0.22)	(0.30)	(0.72)
ROE	-2.373***	-3.297***	-3.369***
	(-5.06)	(-4.62)	(-6.39)
AGE	-0.017	-0.040	-0.020
	(-0.79)	(-1.22)	(-0.81)
PUNISH	-0.075	-0.069	-0.068
	(-0.26)	(-0.16)	(-0.21)
MTB	-0.074***	-0.118***	-0.096***
	(-4.03)	(-4.25)	(-4.66)
FCF	-1.124	-1.897	-1.475*
	(-1.47)	(-1.63)	(-1.72)
INDDR	2.117	2.771	2.180
	(1.33)	(1.15)	(1.22)
CON	1.449**	2.702**	1.425*
	(2.09)	(2.56)	(1.83)
Industry dummies	Y	Y	Y
Year dummies	Y	Y	Y
Random province effects	Y	Y	Y
Random firm effects	Y	Y	Y
Intercept	-0.231	0.053	-0.378
	(-0.24)	(0.04)	(-0.36)
N	5251	5251	5251
Wald chi2	139.740	149.460	186.266

Notes: This table adds to Table 2.5 by including the interaction between government ownership and political connections. ***, ** and * indicate statistical significance at 1 %, 5 %, and 10 % levels respectively (two-tailed), z-values are below the regression coefficients in parentheses. Individual coefficients of the industry dummies, year dummies, and random province and firm effects are not reported for parsimony. See Table 2.2 for variable definitions.

Table A.2: Effects of political embeddedness on earnings management substitution dummies (with interaction between GOV and PC)

	$AM_{LOW}RM_{HIGH}$	$AM_{HIGH}RM_{LOW}$	$AM_{HIGH}RM_{HIGH}$	$AM_{LOW}RM_{LOW}$
	Model 1	Model 2	Model 3	Model 4
GOV	0.283**	-0.399***	0.069	0.151
	(2.31)	(-3.39)	(0.56)	(1.26)
PC	0.126	-0.265**	0.322***	-0.129
	(0.99)	(-2.23)	(2.60)	(-1.05)
GOV*PC	-0.129	0.291**	0.043	-0.253*
	(-0.87)	(2.01)	(0.29)	(-1.72)
SIZE	-0.053**	0.128***	-0.285***	0.282***
	(-1.97)	(4.48)	(-10.27)	(9.30)
LEV	0.560***	-0.706***	0.638***	-1.793***
	(3.27)	(-3.46)	(3.68)	(-7.87)
LIQ	0.013	-0.064*	-0.000	-0.031
	(0.40)	(-1.88)	(-0.01)	(-0.92)
GO	-0.011	0.028	0.047	-0.164***
	(-0.29)	(0.83)	(1.31)	(-3.67)
ROE	-0.950***	2.065***	-1.900***	2.606***
	(-5.08)	(8.83)	(-9.90)	(9.17)
AGE	-0.010	0.017*	0.006	-0.006
	(-1.14)	(1.93)	(0.64)	(-0.69)
PUNISH	0.051	0.199*	-0.093	-0.165
	(0.43)	(1.75)	(-0.81)	(-1.31)
MTB	-0.061***	0.062***	-0.021***	0.015
	(-6.88)	(8.00)	(-2.92)	(1.44)
FCF	-0.604**	-0.524*	0.765**	0.306
	(-2.03)	(-1.70)	(2.52)	(0.92)
INDDR	2.205***	-0.514	-0.028	-2.153***
	(3.62)	(-0.80)	(-0.04)	(-3.26)
CON	0.993***	-0.467*	-0.120	-0.652**
	(3.64)	(-1.66)	(-0.42)	(-2.31)
Industry dummies	Y	Y	Y	Y
Year dummies	Y	Y	Y	Y
Random province effects	Y	Y	Y	Y
Random firm effects	Y	Y	Y	Y
Intercept	-1.663***	-1.786***	0.376	-1.489***
	(-4.24)	(-4.46)	(0.94)	(-3.64)
N	5271	5271	5271	5271
Wald chi2	292.179	336.557	408.597	430.162

Notes: This table adds to Table 2.6 by including the interaction between government ownership and political connections. ***, ** and * indicate statistical significance at 1 %, 5 %, and 10 % levels respectively (two-tailed), z-values are below the regression coefficients in parentheses. Individual coefficients of the industry dummies, year dummies, and random province and firm effects are not reported for parsimony. See Table 2.2 for variable definitions.

Table A.3: Effects of political embeddedness on earnings management substitution dummies (built with RM_CD)

	$AM_{LOW}RM_{HIGH}$	$AM_{HIGH}RM_{LOW}$	$AM_{HIGH}RM_{HIGH}$	$AM_{LOW}RM_{LOW}$
	Model 1	Model 2	Model 3	Model 4
GOV	0.159**	-0.181**	0.053	0.028
	(2.03)	(-2.36)	(0.69)	(0.35)
PC	0.055	-0.076	0.344***	-0.314***
	(0.74)	(-1.01)	(4.45)	(-4.17)
SIZE	-0.046*	0.122***	-0.288***	0.273***
	(-1.71)	(4.35)	(-10.44)	(9.10)
LEV	0.456***	-0.449**	0.516***	-1.598***
	(2.68)	(-2.29)	(3.02)	(-7.13)
LIQ	0.008	-0.027	-0.028	-0.018
	(0.24)	(-0.80)	(-0.84)	(-0.55)
GO	-0.014	0.075**	-0.002	-0.153***
	(-0.36)	(2.29)	(-0.06)	(-3.43)
ROE	-0.793***	1.538***	-1.580***	2.251***
	(-4.28)	(7.01)	(-8.59)	(8.21)
AGE	-0.015*	0.017*	0.005	-0.002
	(-1.68)	(1.95)	(0.58)	(-0.27)
PUNISH	-0.001	0.256**	-0.153	-0.110
	(-0.01)	(2.29)	(-1.32)	(-0.88)
MTB	-0.059***	0.053***	-0.014**	0.014
	(-6.70)	(7.08)	(-2.08)	(1.44)
FCF	-0.552*	-0.215	0.498*	0.242
	(-1.86)	(-0.70)	(1.66)	(0.74)
INDDR	2.223***	-0.316	-0.226	-2.182***
	(3.67)	(-0.50)	(-0.35)	(-3.31)
CON	1.013***	-0.385	-0.173	-0.701**
	(3.76)	(-1.38)	(-0.60)	(-2.47)
Industry dummies	Y	Y	Y	Y
Year dummies	Y	Y	Y	Y
Random province effects	Y	Y	Y	Y
Random firm effects	Y	Y	Y	Y
Intercept	-1.531***	-1.996***	0.506	-1.459***
	(-3.96)	(-5.08)	(1.27)	(-3.61)
N	5271	5271	5271	5271
Wald chi2	269.208	262.989	365.157	367.142

Notes: This table adds to Table 2.6 by constructing the value of dependent variables with RM_CD. ***, ** and * indicate statistical significance at 1 %, 5 %, and 10 % levels respectively (two-tailed), z-values are below the regression coefficients in parentheses. Individual coefficients of the industry dummies, year dummies, and random province and firm effects are not reported for parsimony. See Table 2.2 for variable definitions.

Table A.4: Effects of political embeddedness on earnings management substitution dummies (built with RM_PD)

	$AM_{LOW}RM_{HIGH}$	$AM_{HIGH}RM_{LOW}$	$AM_{HIGH}RM_{HIGH}$	$AM_{LOW}RM_{LOW}$
	Model 1	Model 2	Model 3	Model 4
GOV	0.168**	-0.147*	0.025	0.019
	(2.16)	(-1.92)	(0.32)	(0.24)
PC	0.056	-0.079	0.354***	-0.318***
	(0.75)	(-1.05)	(4.54)	(-4.20)
SIZE	-0.066**	0.121***	-0.283***	0.304***
	(-2.45)	(4.26)	(-10.23)	(9.96)
LEV	0.536***	-0.791***	0.769***	-1.739***
	(3.17)	(-3.89)	(4.46)	(-7.56)
LIQ	0.014	-0.069**	0.007	-0.029
	(0.44)	(-2.04)	(0.21)	(-0.85)
GO	-0.024	0.029	0.051	-0.138***
	(-0.62)	(0.87)	(1.45)	(-3.08)
ROE	-0.573***	1.680***	-1.647***	1.873***
	(-3.13)	(7.45)	(-8.86)	(6.90)
AGE	-0.017*	0.026***	-0.004	0.001
	(-1.95)	(2.91)	(-0.45)	(0.08)
PUNISH	-0.025	0.259**	-0.160	-0.083
	(-0.21)	(2.33)	(-1.37)	(-0.67)
MTB	-0.055***	0.053***	-0.013*	0.014
	(-6.34)	(6.96)	(-1.87)	(1.39)
FCF	-0.562*	-0.442	0.690**	0.288
	(-1.90)	(-1.44)	(2.29)	(0.87)
INDDR	1.678***	-0.684	0.143	-1.637**
	(2.76)	(-1.07)	(0.22)	(-2.50)
CON	1.107***	-0.600**	0.073	-0.801***
	(4.12)	(-2.14)	(0.25)	(-2.80)
Industry dummies	Y	Y	Y	Y
Year dummies	Y	Y	Y	Y
Random province effects	Y	Y	Y	Y
Random firm effects	Y	Y	Y	Y
Intercept	-1.283***	-1.687***	0.189	-1.768***
	(-3.33)	(-4.29)	(0.47)	(-4.36)
N	5271	5271	5271	5271
Wald chi2	260.395	285.609	380.758	380.204

Notes: This table adds to Table 2.6 by constructing the value of dependent variables with RM_PD. ***, ** and * indicate statistical significance at 1 %, 5 %, and 10 % levels respectively (two-tailed), z-values are below the regression coefficients in parentheses. Individual coefficients of the industry dummies, year dummies, and random province and firm effects are not reported for parsimony. See Table 2.2 for variable definitions.

Appendix B

Appendix to Chapter 3

Table B.1: Effects of political embeddedness on CSR reporting and CSRP (with interaction between GOV and PC)

	CSR	RKS	ESG
	Model 1	Model 2	Model 3
GOV	0.843***	1.494*	0.489
	(6.50)	(1.91)	(1.62)
PC	0.696***	2.109***	0.592**
	(6.11)	(3.00)	(2.17)
GOV*PC	-0.263*	0.432	0.126
	(-1.71)	(0.45)	(0.34)
SIZE	0.177***	0.355	-0.092
	(4.29)	(1.27)	(-0.87)
AGE	0.034***	-0.305***	-0.033*
	(3.96)	(-6.67)	(-1.83)
ROA	5.746***	16.709***	7.078***
	(9.28)	(2.97)	(3.34)
LEV	0.867***	11.511***	4.180***
	(4.26)	(7.83)	(7.37)
GROWTH	-0.120***	-0.642	0.280
	(-3.00)	(-0.95)	(1.08)
FCF	0.698***	-2.301	-0.237
	(3.51)	(-0.89)	(-0.24)
INDEPENDENCE	0.879	5.932	0.181
	(1.33)	(1.46)	(0.12)
VISIBILITY	-0.199***	-0.688	-0.128
	(-3.69)	(-1.35)	(-0.57)
CROSSLISTING	0.830***	7.655***	3.628***
	(5.34)	(10.77)	(9.51)
Industry dummies	Y	Y	Y
Year dummies	Y	Y	Y
Random province effects	Y	Y	Y
Random firm effects	Y	Y	Y
Intercept	-4.520***	21.427***	15.090***
	(-5.75)	(4.27)	(7.80)
N	15307	1862	2804
Wald chi2	735.120	721.985	550.384

Notes: Model 1 of this table adds to Table 3.5 by including the interaction between government ownership and political connections. Models 2-3 of this table add to Table 3.6 by including the interaction between government ownership and political connections. ***, ** and * indicate statistical significance at 1 %, 5 %, and 10 % levels respectively (two-tailed), z-values are below the regression coefficients in parentheses. Individual coefficients of the industry dummies, year dummies, and random province and firm effects are not reported for parsimony. See Table 3.2 for variable definitions.

Table B.2: Effects of political embeddedness on the CSRP-CFP trade-off (with interaction between GOV and PC)

Dependent:	$CSRP_{High}$ & CFP_{Low}				$CSRP_{Low}$ & CFP_{High}			
	RKS_{high} TQ_{low}	RKS_{high} PB_{low}	ESG_{high} TQ_{low}	ESG_{high} PB_{low}	RKS_{low} TQ_{high}	RKS_{low} PB_{high}	ESG_{low} TQ_{high}	ESG_{low} PB_{high}
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8
GOV	0.137	0.307	0.194	0.244	-0.438**	-0.480**	-0.078	-0.220
	(0.47)	(1.05)	(0.77)	(1.03)	(-2.01)	(-2.28)	(-0.40)	(-1.13)
PC	0.307	0.358	0.332	0.070	-0.130	-0.014	-0.198	-0.159
	(1.10)	(1.34)	(1.33)	(0.32)	(-0.69)	(-0.08)	(-1.12)	(-0.90)
GOV*PC	0.548	0.249	0.075	0.207	-0.425	-0.332	-0.451*	-0.231
	(1.61)	(0.75)	(0.26)	(0.77)	(-1.56)	(-1.23)	(-1.73)	(-0.91)
SIZE	0.255***	0.323***	0.282***	0.319***	-0.232***	-0.264***	-0.165**	-0.232***
	(2.73)	(3.36)	(3.21)	(3.92)	(-2.69)	(-3.10)	(-2.23)	(-3.12)
AGE	0.030*	0.018	0.016	0.012	0.051***	0.051***	-0.007	0.005
	(1.93)	(1.21)	(1.01)	(0.80)	(3.75)	(3.75)	(-0.54)	(0.37)
ROA	-4.173**	-5.367***	-6.070***	-6.331***	-0.200	1.402	4.245***	5.255***
	(-2.30)	(-3.31)	(-3.44)	(-4.07)	(-0.11)	(0.80)	(2.79)	(3.44)
LEV	3.994***	1.137**	4.284***	1.205***	-4.946***	-1.856***	-4.626***	-1.394***
	(7.12)	(2.33)	(7.78)	(2.80)	(-10.84)	(-4.05)	(-10.68)	(-3.22)
GROWTH	0.032	-0.328*	-0.138	-0.422***	0.321*	0.394**	0.067	0.064
	(0.17)	(-1.66)	(-1.00)	(-2.98)	(1.80)	(2.37)	(0.47)	(0.47)
FCF	1.259*	0.990	-0.039	0.288	1.275*	1.023	-0.907*	-0.674
	(1.77)	(1.61)	(-0.07)	(0.57)	(1.83)	(1.52)	(-1.68)	(-1.39)
INDEPENDENCE	0.204	0.364	1.037	0.556	1.546	0.764	1.548	0.969
	(0.15)	(0.28)	(0.72)	(0.39)	(1.22)	(0.62)	(1.47)	(0.95)
VISIBILITY	-0.072	-0.089	-0.209*	-0.268*	0.165	0.167	-0.116	-0.060
	(-0.53)	(-0.56)	(-1.67)	(-1.96)	(1.34)	(1.44)	(-0.77)	(-0.47)
CROSSLISTING	0.748***	0.801***	-0.529*	-0.588**	-0.445	-0.590*	-1.366***	-2.029***
	(3.16)	(3.53)	(-1.86)	(-2.15)	(-1.39)	(-1.88)	(-4.13)	(-5.28)
Industry dummies	Y	Y	Y	Y	Y	Y	Y	Y
Year dummies	Y	Y	Y	Y	Y	Y	Y	Y
Random province effects	Y	Y	Y	Y	Y	Y	Y	Y
Random firm effects	Y	Y	Y	Y	Y	Y	Y	Y
Constant	-9.549***	-8.290***	-9.803***	-7.667***	5.865***	4.159***	5.295***	3.914***
	(-5.01)	(-4.40)	(-5.80)	(-4.98)	(3.67)	(2.60)	(3.88)	(2.87)
N	3236	3246	3390	3386	3260	3250	3382	3433
Wald chi2	334.093	340.971	229.432	167.676	404.281	254.175	335.294	184.233

Notes: This table adds to Panel A of Table 3.7 by including the interaction between government ownership and political connections. ***, ** and * indicate statistical significance at 1 %, 5 %, and 10 % levels respectively (two-tailed), z-values are below the regression coefficients in parentheses. Individual coefficients of the industry dummies, year dummies, and random province and firm effects are not reported for parsimony. See Table 3.2 for variable definitions.

Appendix C

Appendix to Chapter 4

Table C.1: Effects of political embeddedness on internationalization and M&A success (with interaction between GOV and PC)
(Dependent: 1: crossborder; 2: volcrossborder; 3/4: car; 5: mtb; 6: risk)

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
L_gov	-0.233	-0.045	-0.014**	-0.015	-0.180**	-0.001
	(-0.56)	(-0.78)	(-2.29)	(-1.44)	(-2.08)	(-0.03)
L_pc	-0.076	-0.018	-0.005	-0.006	-0.042	0.004
	(-0.34)	(-0.54)	(-1.22)	(-0.90)	(-0.80)	(0.39)
L_igovpc	-0.231	-0.010	0.012*	0.010	0.017	0.018
	(-0.54)	(-0.17)	(1.82)	(0.87)	(0.20)	(0.98)
L_size	0.475***	0.062***	-0.014***	-0.021***	-0.806***	-0.000
	(5.01)	(4.60)	(-8.99)	(-8.52)	(-35.66)	(-0.09)
L_lev	-1.254**	-0.124*	0.025***	0.036***	-0.671***	-0.003
	(-2.47)	(-1.82)	(3.24)	(2.78)	(-6.22)	(-0.14)
L_roa	2.513	0.183	-0.168***	-0.204***	3.561***	-0.085
	(1.19)	(0.67)	(-5.40)	(-3.82)	(8.98)	(-0.99)
L_fcfrate	0.199	-0.007	-0.003	-0.011	0.013	0.014
	(0.24)	(-0.07)	(-0.23)	(-0.52)	(0.09)	(0.38)
L_growth	0.182	-0.017	0.005	0.004	0.180***	0.038**
	(0.55)	(-0.38)	(1.01)	(0.44)	(2.87)	(2.53)
L_age	-0.011	0.001	0.001**	0.001	0.003	0.001
	(-0.62)	(0.44)	(2.26)	(1.06)	(0.51)	(0.92)
L_mgtshare	-0.473	-0.067	0.003	0.010	-0.247*	0.032
	(-0.83)	(-0.78)	(0.34)	(0.61)	(-1.72)	(1.23)
L_hhi10	0.052	0.113	0.024**	0.037**	0.560***	0.001
	(0.08)	(1.15)	(2.23)	(2.18)	(3.46)	(0.02)
L_independent	-2.546	-0.446**	0.017	0.013	0.934***	-0.056
	(-1.64)	(-2.13)	(0.72)	(0.34)	(2.96)	(-0.86)
L_board	-0.009	0.001	0.000	-0.001	0.016	0.000
	(-0.18)	(0.15)	(0.24)	(-0.45)	(1.47)	(0.22)
L_duality	0.181	0.015	-0.002	-0.003	0.075*	-0.005
	(1.02)	(0.56)	(-0.54)	(-0.66)	(1.84)	(-0.62)
L_intershare	0.376	0.145**	-0.004	0.002	0.261**	-0.009
	(1.22)	(2.46)	(-0.65)	(0.24)	(2.38)	(-0.56)
completion			0.020***	0.034***	0.020	0.002
			(8.82)	(8.78)	(0.76)	(0.31)
attitude			0.002	0.003	-0.001	0.002
			(0.63)	(0.45)	(-0.01)	(0.16)
divestiture			0.004*	0.008*	-0.005	-0.001
			(1.81)	(1.87)	(-0.18)	(-0.22)
cashmerger			-0.012***	-0.016***	-0.074**	0.005
			(-4.72)	(-3.62)	(-2.43)	(0.60)
tglist			0.025***	0.042***	0.095	0.025
			(3.42)	(3.23)	(1.12)	(1.16)
horizontal			-0.003	-0.002	-0.061*	0.000
			(-1.07)	(-0.48)	(-1.85)	(0.02)

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Industry dummies	Y	Y	Y	Y	Y	Y
Year dummies	Y	Y	Y	Y	Y	Y
Random province effects	Y	Y	Y	Y	Y	Y
Random firm effects	Y	Y	Y	Y	Y	Y
Intercept	-10.578***	-0.488	0.215***	0.369***	17.901***	0.955***
	(-4.73)	(-1.38)	(5.48)	(5.71)	(30.67)	(3.80)
N	5482	5576	4883	4883	5347	5277
Wald chi2	81.946	106.767	616.657		5418.662	18019.520

Notes: Models 1-6 add to Model A (Table 4.5), Model C (Table 4.5), Model E (Table 4.6), Model G (Table 4.6), Model I (Table 4.7), and Model K (Table 4.7) respectively by including the interaction between government ownership and political connections. ***, ** and * indicate statistical significance at 1 %, 5 %, and 10 % levels respectively (two-tailed), z-values (for random effect models and logistic models) and t-values (for quantile regressions) are below the regression coefficients in parentheses. Individual coefficients of the industry dummies, year dummies, and random province and firm effects are not reported for parsimony. See Table 4.1 for variable definitions.

List of Figures

List of Tables

Summary

This dissertation aims to investigate how political embeddedness influences firms' strategies such as financial and non-financial reporting and internationalization. I have identified whether and how political embeddedness (i.e., government ownership and political connections, both at the central and the local level) affects corporate reporting strategies, particularly in light of the recent policy changes regarding the financial and non-financial reporting of firms in China. In addition, considering the recent government programs that were introduced to facilitate Chinese IFDI and OFDI, I have investigated the effect of political embeddedness on Chinese firms' internationalization strategies as well. Specifically, Chapters 2-4 examine the influence of political embeddedness on firms' use of earnings management, CSR reporting, and the propensity to internationalize, respectively.

Chapter 2 examines whether and how different types and levels of political embeddedness influence the quality of financial reporting in China. This was accomplished by investigating how central and local levels of government ownership and political connections influence the choices of the earnings management strategies of the listed Chinese firms. Using a panel data set of 5,531 publicly traded firms in China, for the years 2009–2013, the results of Chapter 2 demonstrate that government-owned firms, and central government-owned firms in particular, are more likely to substitute accrual-based earnings management with costlier, albeit less detectable, real earnings management strategies than non-government-owned firms. The results of this chapter additionally indicate that, compared to firms without political connections, firms with political connections are more likely to resort to less detectable real earnings management strategies. Although to a lesser extent, these firms are also more likely to increase the use of accrual-based earnings management, indicating a relative substitution effect. The results indicate that, by affecting the trade-off between accrual-based and real earnings management strategies disparately, different types and levels of political embeddedness influence firms' choices of earnings management strategies, and thus the earnings quality.

By examining whether and how political embeddedness influences the diffusion

of corporate social responsibility (CSR) practices in China, Chapter 3 reveals the relationship between political embeddedness and the quality of corporate non-financial information. Specifically, this chapter investigates how government ownership and political connections influence the listed Chinese firms' likelihood of issuing CSR reports. It also examines the underlying CSR performance (CSRP) and its relationship with the firms' financial performance (CFP). Using the panel data of 15,419 publicly traded firm-year observations in China for the years 2008–2014, the results of this chapter demonstrate that politically embedded firms, particularly firms that are centrally politically embedded, are more likely to issue CSR reports than firms without political embeddedness. The results of this chapter additionally indicate that politically embedded firms, on average, have a higher CSRP than non-politically embedded firms. In addition, the results indicate that, for politically embedded firms, CSRP is more negatively related with financial performance than for firms without political embeddedness. This indicates that political embeddedness also affects the trade-off between CFP and CSRP. This chapter thus provides the first evidence not only on the effectiveness of government-induced CSR policies, but also on their efficiency (i.e., the potential opportunity costs that they imply). The results also demonstrate that different types and levels of political embeddedness play significant, albeit different, roles in explaining the CSR-related practices of firms.

Cross-border M&As are a dominant form of FDI and linked closely to internationalization strategies. Since cross-border M&As are government-supported investment activities, it is important to identify the roles that political embeddedness play in influencing firms' internationalization strategies with regard to the government's relevant policy changes. Chapter 4 is dedicated to responding to this call and investigating whether and how political embeddedness influences firms' propensity for conducting cross-border M&As and their success in China. I contend that institutional constraints, and consequential resource allocation and industry traits influence both politically embedded enterprises and firms without political embeddedness. Therefore, building on prior theories over international business, I developed a theoretical Chinese specific "strategy tripod" framework centered on an institution-based perspective and incorporating resource- and industry-based views. Using a panel data set with 30,314 firm-year observations of publicly traded firms in China from 2000 to 2015, the results demonstrate that state-owned enterprises (SOEs) conduct fewer cross-border M&As than non-SOEs. Compared with non-SOEs, SOEs benefit less from M&A activities. The level of government ownership matters, in that central SOEs conduct more cross-border M&As and benefit more from M&A activities than local SOEs. The results additionally indicate that political connections do not play a significant role in explaining a firm's propensity for conducting cross-border M&As or M&A success. The findings in Chapter 4 indicate that different types and levels of political embeddedness in China influence firms' propensity for conducting cross-border M&As and M&A success differently.

Nederlandse samenvatting (Dutch summary)

In deze scriptie heb ik willen onderzoeken op welke wijze politieke inbedding invloed heeft op bedrijfsstrategieën zoals financiële en niet-financiële rapportages en internationalisering. Ik heb vastgesteld of en hoe politieke inbedding (d.w.z. overheidsparticipatie en politieke connecties, zowel op centraal als op lokaal niveau) zakelijke rapportagestrategieën beïnvloeden, vooral in het licht van recent gewijzigd beleid ten aanzien van de financiële en niet-financiële rapportages van bedrijven in China. Gezien de recente overheidsprogramma's die zijn geïntroduceerd om Chinese inkomende FDI (IFDI) en uitgaande FDI (OFDI) te faciliteren, heb ik daarnaast ook onderzoek verricht naar het effect van politieke inbedding op de internationalisering van Chinese bedrijven. Vooral in hoofdstuk 2 t/m 4 wordt gekeken naar de invloed van politieke inbedding op het gebruik van respectievelijk 'earnings management' (winststuring), CSR-rapportage en de bereidheid van bedrijven tot internationalisering.

Hoofdstuk 2 onderzoekt of en hoe verschillende soorten en niveaus van politieke inbedding invloed hebben op de kwaliteit van financiële rapportage in China. Hiervoor heb ik onderzocht hoe centrale en lokale niveaus van overheidsparticipatie en politieke connecties de keuze voor de earnings management-strategieën van de genoteerde Chinese bedrijven beïnvloeden. De resultaten in hoofdstuk 2 komen voort uit een paneldataset van 5.531 beursgenoteerde bedrijven in China over de jaren 2009-2013. Deze resultaten laten zien dat overheidsbedrijven, en centrale overheidsbedrijven in het bijzonder, sneller 'accrual-based earnings management' (winststuring door middel van de manipulatie van accruals) zullen vervangen door het kostbaardere, zij het minder detecteerbare, 'real earnings management' (winststuring door middel van reële transacties) dan niet-overheidsbedrijven. Uit dit hoofdstuk blijkt bovendien dat bedrijven met politieke connecties eerder gebruik zullen maken van minder detecteerbare real earnings management-strategieën dan bedrijven zonder politieke connecties. Hoewel in mindere mate, zullen deze bedrijven ook vaker gebruik maken van accrual-based earnings management,

hetgeen wijst op een relatief substitutie-effect. Door de wisselwerking tussen accrual-based en real earnings management-strategieën disparaat te beïnvloeden, hebben verschillende soorten en niveaus van politieke inbedding invloed op de keuze van bedrijven voor earnings management-strategieën, en daarmee op de kwaliteit van de winst.

Hoofdstuk 3 onderzoekt of en hoe politieke inbedding invloed heeft op de verspreiding van praktijken van maatschappelijk verantwoord ondernemen (Corporate Social Responsibility/CSR) in China en toont daarmee de relatie aan tussen politieke inbedding en de kwaliteit van niet-financiële bedrijfsinformatie. Specifiek wordt onderzocht welke rol overheidsparticipatie en politieke connecties spelen in de bereidheid van genoteerde Chinese bedrijven om CSR-rapporten te verstrekken. Ook wordt in dit hoofdstuk gekeken naar de onderliggende CSR-prestaties (CSRP) en hun relatie met de financiële prestaties van bedrijven (CFP). De resultaten zijn gebaseerd op de paneldata van 15.419 bedrijfsjaarobservaties van beursgenoteerde Chinese bedrijven over de jaren 2008-2014. Deze resultaten laten zien dat politiek ingebedde bedrijven, vooral bedrijven die centraal politiek zijn ingebed, eerder CSR-rapportages zullen verstrekken dan bedrijven zonder politieke inbedding. Uit deze resultaten blijkt bovendien dat politiek ingebedde bedrijven gemiddeld hogere CSRP hebben dan bedrijven die niet politiek zijn ingebed. Daarnaast geven de resultaten aan dat de CSRP voor politiek ingebedde bedrijven negatiever verband houden met de financiële prestaties dan voor bedrijven zonder politieke inbedding. Dit wijst erop dat politieke inbedding ook effect heeft op de wisselwerking tussen CFP en CSRP. Dit hoofdstuk levert daarmee niet alleen het eerste bewijs voor de effectiviteit van CSR-beleid door de overheid, maar ook voor de efficiency ervan (d.w.z. de alternatieve kosten die hiervan mogelijk het gevolg zijn). De resultaten laten ook zien dat verschillende soorten en niveaus van politieke inbedding een belangrijke, hetzij verschillende, rol spelen in de CSR-gerelateerde praktijken van bedrijven.

Grensoverschrijdende fusies en overnames (mergers & acquisitions/M&A's) vormen een dominante vorm van directe buitenlandse investeringen (FDI) die nauw verband houden met internationaliseringsstrategieën. Grensoverschrijdende M&A-activiteiten zijn investeringsactiviteiten met overheidssteun. Daarom is het belangrijk vast te stellen welke invloed politieke inbedding heeft op de internationaliseringsstrategieën van bedrijven met betrekking tot relevante wijzigingen van overheidsbeleid. In hoofdstuk 4 wordt een reactie op dit appel gegeven. Ook wordt onderzocht of en hoe politieke inbedding invloed heeft op de bereidheid van bedrijven om tot grensoverschrijdende fusies en overnames over te gaan en het succes van deze M&A's in China. Ik beweer hierbij dat institutionele beperkingen, en de daaruit volgende toewijzing van middelen en industriekenmerken, invloed hebben op zowel politiek ingebedde ondernemingen als op bedrijven zonder

politieke inbedding. Voortbouwend op eerdere theorieën over het internationale bedrijfsleven heb ik daarom een theoretisch drieledig strategiekader ontwikkeld dat specifiek op China van toepassing is. In dit kader staan een institutioneel perspectief en zienswijzen waarin wordt uitgegaan van middelen en industrie centraal. Resultaten op basis van een paneldataset met 30.314 bedrijfsjaarobservaties van beursgenoteerde bedrijven in China over de jaren 2000-2015 laten zien dat staatsbedrijven (State-Owned Enterprises (SOE's) minder vaak overgaan tot grensoverschrijdende fusies en overnames dan niet-staatsbedrijven. Vergeleken met niet-SOE's hebben SOE's minder profijt van M&A-activiteiten. Het niveau van overheidsparticipatie speelt daarbij een rol. Centrale SOE's gaan namelijk vaker over tot grensoverschrijdende M&A's en profiteren meer van M&A-activiteiten dan lokale SOE's. De resultaten laten bovendien zien dat politieke connecties geen belangrijke rol spelen bij de bereidheid van bedrijven om grensoverschrijdende M&A's aan te gaan of bij het welslagen van deze fusies en overnames. De bevindingen in hoofdstuk 4 wijzen uit dat verschillende soorten en niveaus van politieke inbedding in China een verschillende invloed hebben op de bereidheid van bedrijven om over te gaan tot grensoverschrijdende fusies en overnames en het succes van deze M&A's.

Biography

Zhi Wang (王志) was born on August 3rd, 1988 in Yumen, Gansu, China. He has been studying public economics and financial economics in Dongbei University of Finance and Economics (DUFE) since 2007 and obtained his master's degree in financial management (cum laude) in 2013. From 2013 to 2014, he worked both as a research and teaching assistant in DUFE, and as a financial consultant in several projects related to state-owned enterprises in China. Since September 2014, he started his PhD research in Department of Economics, Radboud University under the supervision of Prof. dr. Utz Weitzel and Dr. Geert Braam, together with Dr. Daniel Reimsbach. During his PhD, Zhi Wang has conducted research related to corporate finance in the Chinese context. He has done several presentations on international conferences. Most notably, he conducted an extensive research visit at SOAS, University of London, where he worked with Prof. dr. Gerhard Kling and other renowned researchers on mergers and acquisitions in China. Zhi Wang will work as an assistant professor in Southwestern University of Finance and Economics from September 2018.